AgVANTAGE

Maximizing Georgia's Agricultural Exports

RECOMMENDATIONS FOR A NEW LEASING LAW FOR GEORGIA

August 10, 2004

ACDI VOCA

by S.C. Gilyeart
JD with Honors (Law), BA with Honors (Economics)
Admitted before the US Tax Court

Submitted by ACDI/VOCA under a USAID/Caucasus Contract No.114-C-00-02-00086-00

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Acknowledgment

This report is issued in connection with a US AID sponsored project, AgVantage, to promote and assist the development and expansion of Georgia's agricultural sector and its exports. However, the recommendations of this report are not sector specific and are designed to allow leasing to better assist all areas of the country's economy.

The author would like to thank US AID, the staff of AgVantage, and others who provided information and insight, with special thanks to Roger Bird and Irakli Kordzakhia for their involved input, review and assistance, and to Tato Tskitishvili for her constant, unruffled competence in the handling of all logistics necessary for a project such as this.

The author would also like to acknowledge the input, analysis and suggestions of many others involved in an effort to improve the commercial law of leasing in Georgia: Sandro Amashukeli, Levan Jioshvili and Frank Lever of the IFC, Garland D. Boyette of GEGI, Thea Lortkipanidze of TBC Leasing and George Putkaradze of Georgian Leasing Company.

It is sincerely hoped that the result of this effort will be new opportunities for the growth of leasing in Georgia and its ability to make its maximum contribution to the Georgian economy and the quality of life of its citizens.

Executive Summary

The Reason for This Proposal

Leasing is a proven tool for financing rapid economic development and has a significant role to play in Georgia. Two bank-affiliated leasing companies have recently commenced business and are eager to expand their financial assistance to lessees in a number of important economic sectors. However, the current tax and commercial law environments make it difficult for leasing to make its greatest possible contribution to the country's economy. This report addresses the legal problems. (A separate, companion report addresses the tax problems.)

Georgia needs a new leasing law. The existing Law on the Promotion of Leasing Activity, as well as the relevant Civil Code provisions, are overlapping, conflicting, ambiguous and inadequate. The current Law on the Promotion of Leasing also limits its application to a very specific type of lease product, a particular type of finance lease defined by accounting criteria, which will by itself constrain and impair the growth, development and innovations of the new leasing industry in Georgia.

This report contains a Parliament-ready proposal for a new leasing law for Georgia. Each article is accompanied by a detailed explanatory comment, and the report itself, including its appendices, contain descriptions and elaborations of international best practices as relevant for this country-specific proposal.

The ultimate goal is Georgia's rapid economic development so that it can take up its natural place as a complete participant in the global economy as quickly as possible. The Proposed Law will help leasing make its significant contribution to that important effort.

Key Aspects of the Proposed Law

Scope of the Law. The proposed law covers only finance leases as defined in the law. Other types of leasing or rental transactions will remain as treated by the existing Civil Code.

Nature of the Law's Provisions. The proposed law will provide for the rights and remedies of parties (lessor, lessee, suppliers and others) and provide guidelines for the contractual drafting of their contracts. However, freedom of contract is preserved; the parties may agree to provisions different than those mentioned in the law. As will all civil commercial laws, this law's primary purpose is to provide rules for those instances not adequately covered by the parties' contracts and agreements.

Examples of some key provisions include:

1. *A definition of finance lease that is appropriate for commercial law's concern with rights, obligations and remedies, rather than accounting or tax;*
2. *A definition that will enable a wide variety of leasing products to develop—and will support and cover them all;*
3. *A preservation of the principle of "freedom of contract" to allow the parties to agree on contracts that vary from the provisions of the law if they so desire;*
4. *An allocation of rights and obligations that are in accord with the parties' roles, which is very different from those of traditional rentals;*
5. *An expedited repossession procedure; and*
6. *Coordination with any bankruptcy, secured transaction and/or lease registry law.*

Special Law v. Amendment of the Civil Code. This law is prepared as a special law that can be enacted by Parliament immediately. Yet, ultimately, its provisions should become incorporated into the Civil Code, and it is drafted with a format that contemplates that ultimate objective.

The Need for the Law

Modern leasing primarily involves a three party transaction where the roles of the parties are quite different from those of a traditional two party transaction. The four thousand year old two party lease (lessor-lessee) is adequately covered by the existing provisions of the Civil Code. The Civil Code apportions the rights and responsibilities in those transactions in a manner appropriate for their respective roles. However, those are not proper or appropriate for the newer, modern lease transaction where the lessee

has selected the equipment and the supplier and the lessor has acquired the equipment only at the lessee's request and specifically for lease to that lessee—the defining characteristic of the modern lease. That situation requires a different treatment than the traditional one where a lessee simply selects from an inventory that the lessor maintains in general. The inadequate and inappropriate handling of these new types of leasing transaction by the existing Civil Code and Law on Leasing compel the need for a new leasing law.

Allowing Leasing to Develop Into a Unique Product

To truly add to a country's economic development, leasing needs to be something different, not just a loan equivalent but its own distinct, product. When leasing first starts in a country, the lease product is equivalent of a loan with a lease label. But this will change over time **if** the legal framework of the country (tax, accounting, commercial law, etc.) will allow it.[1] The legal framework in more than a few countries, such as Korea, have hindered and essentially prevented the growth and development of leasing beyond that loan equivalent product. A legal framework conducive to leasing is always a critical need. At a minimum, this means that the legal environment is neutral. It is hardly ever this way in the beginning. Commercial loans from banks, with which leases initially compete, always have the advantage, e.g., a lower cost of funds, interest exemption from VAT, better court enforcement mechanisms, well-understood Civil Code provisions, etc.

The Recognized Value of a Strong and Viable Leasing Industry

The value to a country of a strong and viable leasing industry has been recognized in many ways.

Worldwide Desirability

Leasing has grown from its inception in the early 1950s to a world-wide US$500 billion industry today and exists in close to half of the world's countries. In developed leasing markets, leasing typically accounts for approximately 20% of all new capital investment, with 80% or more of companies leasing needed equipment. In OECD countries, up to a third of private investment is financed through leases.

Research Validation

One European study[2] found that for every 8-9 points in leasing's growth in a country GDP grew an average of 1%. It also found that when leasing was more than 1.7%-1.8% of GDP, the unemployment rate was below the critical level of 10%. The study's summary conclusion was that "*After having examined this data, we think that the leasing business is absolutely critical in the formulation of any type of economic policies that seek to encourage increased investments.*" (Italics added.)

[1] Please see *The Six Phases of the Leasing Cycle*, in the Appendices.
[2] Leaseurope, *The Leasing Market In Europe Compared With Some Macro-Economic Indicators: An Empirical Analysis*, July 1999

An Expansion of Financial Products, Not a Displacement

Leasing does not displace traditional finance, such as bank loans, but adds to it a new and different product that reaches companies and businesses that are often unable to get traditional bank loans, especially SMEs[3]. In fact, many banks will get into leasing to provide their customers with greater choice.

Allows More Businesses, Particularly SMEs Access to Financing

Lessors are often willing to do a lease transaction with parties who may not be able to qualify for traditional bank loans. In doing so, lessors are generally taking greater credit risks than banks are. The higher risk is undertaken due to the fact that leasing (in the hands of independent lessors) is generally unregulated or mildly regulated. Lessors are not therefore fearful of having their leases be classified as bankers always are. The higher risk is also undertaken due to the fact that lessors, as owners of the leased assets, may, in some countries, be able to repossess the equipment more easily than a bank can foreclose on collateral. Thus, leasing allows SMEs to access capital that is otherwise not available. SMEs undoubtedly play a very significant role in most if not all emerging markets.

Increases the Domestic Capital Base

Leasing needs its own funding, and this tends to expand domestic capital. A significant portion of this funding comes from the lease companies' own bank lines. While leasing companies are not generally allowed to accept public deposits, the banks lending to lease companies of course do accept public deposits and the increased borrowing requirements by their lease company customers necessitates an increase in the banks own deposit-taking, with the consequential increase in the domestic capital base.

Provides Competition to Traditional Banks

Depending upon the language of a country's banking laws, leasing may first be introduced by a bank either directly or by acting through a subsidiary established for the purpose, or, if regulations permit, by an independent lease company. Regardless, leasing ultimately provides an additional source of financing in the marketplace and a product in competition with traditional bank products. Such competition generally compels banks to become more efficient in their lending practices. Additionally, as banks begin to recognize the value of leasing as a new type of financially-oriented product, they add it to the range of services that they offer their customers. Banks always become major participants in the leasing industry, and in fact, are usually the ones who start it.

[3] Small and Medium Sized Enterprises

Encourages Financial Product Innovation

Because leasing companies are very capital consumptive in their expanding purchases of more and more equipment for lease to their lessees, leasing companies also tend to be at the forefront of new capital market financial product development. For example, leasing companies, in addition to promoting issuance of commercial paper, bonds, stock offerings and similar capital products, can encourage the introduction of non-recourse lending, securitization, and other more sophisticated investment vehicles--all of which can help the country attract not only domestic capital but foreign capital as well.

Helps to Develop Secondary Markets

Although the initial lease product offered in a country is almost always full-payout with no reliance on residual, and the equipment is transferred to the lessee at the end of the lease term for a nominal amount, lessors will ultimately begin to take a true residual value position that will require them to dispose of the asset at a price that will at least maintain the pre-targeted return in the lease transaction. In a number of emerging economies, there are severely limited organized markets for used equipment. Leasing, because it generates a steady supply of used equipment, can facilitate the development of an organized secondary market for a variety of goods. Vehicles and other transportation equipment, because of their high residual values and ready salability, are typically the type of asset that leads the way.

To summarize, leasing plays a significant role in the economic development of emerging countries. By providing additional capital, it facilitates additional business investment. This in turn adds to the employment base, increases the tax base, and creates growth in the gross domestic product.

An Important Comment about Lease Terminology

Unending confusion and misunderstanding reigns supreme over four very frequently used terms (and their gerunds):

1. *lease (and leasing)*
2. *rent (and renting)*
3. *finance lease (financial leasing)*
4. *operating lease (operating leasing)*

These terms are commonly used without consistency in every regard: dictionary meaning, industry meaning, legal meaning, tax meaning, accounting meaning or any other meaning. They are used as synonyms, as mutually exclusive, as terms of art, as slang shorthand—often in a single conversation by the same person. This has been going on for years and is not getting any better. It is no wonder that modern leasing is poorly understood.

Now, for some critical clarification:

Lease v. Rental

Dictionaries will show "lease" and "rent" to be synonyms. So will a large number of commercial laws covering these subjects. However, in recent decades "lease" has come to imply a longer term lease, and "rent" has come to imply a shorter term lease, with the one year mark distinguishing the two.

Finance lease v. operating lease

"Finance lease" and "operating lease" are first and foremost accounting terms. They originate from the first lease accounting standard, the United States Standard of Financial Accounting, *SFAS 13* (more commonly knows as *FASB 13*). FASB 13 came out in 1976. Actually the original term was "capital lease" rather than "finance lease"--the more accurate label, as a "capital lease" was a lease that had to be capitalized on the books of the lessee. The International Accounting Standard for Leases, *IAS 17*, was issued by the International Accounting Standards Committee ("IASC"), based in London, in 1982[4], some 6 years later. IAS 17 is almost a copy of FASB 13, with the main differences being a shift to language-based tests rather than numerical tests, and the substitution of the phrase "finance lease" for "capital lease." The United Kingdoms Statement of Standard Accounting Practice for leases, SSAP 21, followed in 1984; it also used the phrase "finance lease" instead of "capital lease." Almost all countries adopting lease accounting standards subsequently used the phrase "finance lease."

Unfortunately, not just accountants were using the phrase "finance lease"; the tax authorities and lawyers started using the phrase as well—*AND without really thinking through or fully appreciating the consequences, started using the* ***accounting*** *classification tests for finance lease as their* ***tax law*** *and* ***commercial law*** *standards*. This was and is not only unnecessary but inadvisable.

Today, the phrase "finance lease" can mean just about anything other than the shortest term rental. Internationally, most think of a "finance lease" as just a purchase on credit. Others include within its coverage leases with residual-based pricing and lessor service packages. Under the US Uniform Commercial Code, only a true lease, i.e., what many call an "operating lease", can be a "finance lease." And almost everyone misses the point—*that a finance lease can be defined differently for different purposes*. The same meaning is not required for tax, for accounting, for commercial law, or any other purpose.[5]

As used in this Report *and in proper usage in any commercial law discussion of leasing*, these four terms will be used as follows:

- *lease*—a lease of a year or more;
- *rental*—a lease of less than a year;
- *finance lease*—a type of lease that creates a different set of commercial legal rights for lessor, lessee and supplier than would exist if the lease was not labeled a finance lease

[4] IAS 17 was revised in 1998, with the revisions being elaborations or clarifications. There was no change in concept or substance.
[5] Please see the Appendix, "The Leasing Infrastructure Matrix"

- *operating lease*—irrelevant; not a term that has a proper usage in the commercial law arena

(For further information, the Appendix *"Leases and Rentals" and "Finance Leases and Operating Leases"* contains more details on this topic.)

The Primary Problem with the Existing Legal Environment

Important Note: This Report of necessity is being prepared using English translations of the relevant Georgian law. The translations are quoted as provided.

The Primary Problem in the Civil Code

The *Civil Code* has three chapters that impact leasing[6]:

- Chapter Three—Rental (Art. 531-576)
- Chapter Four—Finance Lease (Art. 576-580)
- Chapter Five—Lease (Art. 581-591)

The differences in scope of these three chapters are not well articulated; the chapters could easily be seen to overlap because of the language used to describe their concept and to establish their scope of application:

Chapter Three--Rental
Article 531. Concept

Under a rental contract the lessor is bound to transfer the thing to the use of the lessee for a specified period of time. The lessee is obligated to pay to the lessor the stipulated rent.

Chapter Four--Finance Lease
Article 576. Concept. Content

1. Under a finance leasing contract the lessor is obligated to transfer to the use of the lessee the specified property for a term fixed by the contract. The lessee is obligated to pay compensation to the lessor in accordance with the specified periodicity.

2. The lessor is obligated to produce or purchase the property specified under the contract.

3. The finance leasing agreement may obligate or entitle the lessee to either purchase or rent the object of the finance lease upon expiration of the term of the agreement, unless the contract ends with the complete depreciation of the thing. In assessing the final value of the thing the fact of depreciation shall be taken into account in any event. Unless there is a contrary provision in the contract, the lessee shall be entitled to purchase the object of the finance lease

Chapter Five--Lease
Article 581. Concept

1. Under a lease contract the lessor is bound to transfer the specified property to the temporary use of the lessee and to [allow the lessee] the possibility of obtaining fruits during the term of the lease, if they are obtained through proper management of the leased property. The lessee is obligated to pay to the lessor the stipulated lease payment. The lease payment may be determined both in money and in kind. The parties may agree on other means of determination of the lease payment as well.

[6] Plus other chapters that cover specific types of lease situations, such as *Chapter Six—Lease of Agricultural Lands*

2. The rules governing a rental contract shall apply to a lease contract unless otherwise provided for under Articles 581-606.

Of course, the chapter headings themselves use words which are synonyms or overlap (rental, lease, finance lease). This is not good.

Clear demarcation needs to exist between the different chapters so that any particular transaction can receive its own proper legal treatment without ambiguity and conflict between the rules. Moreover, many of the articles in the Civil Code are inappropriate and improper for modern leasing transactions.

But there is more.

The Primary Problem in The Law on the Promotion of Leasing

Georgia also has a special *Law of Georgia on Promotion of Leasing Activity*, enacted 7 May 2002 ("Leasing Law"). It deals with the rights and obligations of lessors, lessees and suppliers—a *commercial law* application—yet the provision that should be establishing its scope does so only for *accounting* purposes:

Article 3. Leasing Agreement

1. An agreement made by the parties ***for accounting and reporting*** shall be deemed the leasing agreement if it contains one of the following provisions:

a) upon expiration of the leasing agreement term the Lessee becomes the owner of the leasing subject in such way that shall not pay any additional amount or such amount is very small;

b) the term of leasing agreement is essentially equal or exceeds the term of economic maintenance of the leasing subject and the Lessee becomes the owner of the leasing subject by payment of a small amount;

c) the term of leasing agreement is essentially equal or exceeds the term of economic maintenance of the leasing subject and the Lessee has not right to terminate the leasing agreement at least without the full payment of the leasing charge;

d) upon expiration of one or some initial terms determined by the leasing agreement the Lessee undertakes to prolong leasing for the full or essentially full term of the economic maintenance of the leasing subject, or to buy the leasing subject;

e) upon expiration of one or some initial terms determined by the leasing agreement the Lessee has the right to decide whether to prolong or not the leasing for the full or essentially full term of the economic maintenance of the leasing subject without payment of the additional amount or by payment of the amount significantly smaller than the market price of the leasing price by the moment of prolongation of leasing;

f) upon expiration of one or some initial terms determined by the leasing agreement the Lessee has the right to decide whether to become or not the owner of the leasing subject without payment of the additional amount or by payment of the amount significantly smaller than the market price of the leasing subject by the moment of becoming the owner.

(Emphasis added.)

In practice, this list of classification criteria is probably used to establish the law's scope, but from a proper legal perspective, it is unclear just what type of transactions this law will apply to, or how its contents relate to similar provisions in the three Civil Code chapters. Ambiguities and confusion abound in not only the scope of these legal

rules' application but in the details of there provisions as well. They exist to a degree sufficient that the Leasing Law should just be replaced, not amended. Recent drafts of a new and improved leasing law have taken just that approach.

Previous Drafting Efforts

There is a current effort by a group led by the International Finance Corporation ("IFC") to draft a new leasing law. While its most recent draft contains many good and appropriate provisions, it cannot be recommended without significant modification. Still, the Proposed Law set forth in this Report strives to utilize as many of the IFC Draft provisions as possible when the IFC Draft covers the relevant issue in appropriate fashion.

The Drafting Approach: Special Law Now, Civil Code Later

There are overlaps in coverage between the Leasing Law and the Civil Code regarding leasing; yet, there have been no amendments to the Civil Code suggested to date. While adoption of a special law may be advisable for reasons of expedient enactment, the legal rules applying to lease transactions ultimately need to be in the Civil Code. It is not good legislative practice to scatter the legal rules for commercial practice partly in a smattering of special laws, partly in various ministry rules, regulations and decrees, and partly in the Civil Code. Conflicts, ambiguities and uncertainly are guaranteed to occur.

As it is unknown how hard or how easy it is to amend the Civil Code of Georgia as a practical matter, the Proposed Law of this Report is drafted as a special law. Georgia needs new, clear and helpful legal rules for leasing as soon as possible. Still, the Proposed Law is organized and structured in a manner that will hopefully make it relatively easy to move it into the Civil Code as soon as that is possible.

The Annotations to the Proposed Law

The Proposed Law is presented as an Appendix to this Report, even though it is the end-product of this effort. This is necessary to make it Parliament-ready. The Annotations are article-by-article for immediate contextual reference. Although many readers may be tempted to read the Proposed Law first and this part of the Report later, it is critical for an informed understanding that the material that follows be read and appreciated first.

Important Note: The term "financial leasing" as used in these materials refers to the modern three-party leasing industry and its practices. It does NOT refer to a particular product type, such as a finance lease. Lessors in today's leasing industry will ultimately offer many types of lease products, of which a "finance lease" is only one type. Nevertheless, modern leasing laws are typically referred to as "financial leasing laws".

Considerations for a Financial Leasing Law

Three Fundamental Drafting Principles

The basic structure of a modern financial lease is quite different from that of a traditional rental, and it needs legal provisions that are often just the opposite of what is appropriate in a rental. For example, under a traditional rental, a lessor would be responsible for equipment defects; under a finance lease, the lessor would not, as the lessee would have chosen the equipment and the supplier and will usually know much more about the equipment than the lessor. The supplier is a critical third party in a modern finance lease. This fact needs to be recognized and the duties assigned by the law need to be consistent with each party's role in the transaction.

Moreover, the law should be just a fall-back framework for parties who fail to cover a topic in their lease agreement or when the provision that they have just does not work in the particular circumstances that occurred. It should not mandate provisions that cannot be changed by contract, and if it does, it should be very explicit that those provisions cannot be changed by the parties' agreement. Freedom of contract must be paramount.

Thus, a good financial leasing law follows three fundamental principles:

1. *A definition of finance lease that is based on recognition of the three-party structure of modern financial leasing and not one based on accounting or tax classification rules;*
2. *Duties consistent with each party's role in the transaction*
3. *Freedom of contract in negotiating the parties' agreements*

Law Limited to Finance Leases

While a number of countries have enacted financial leasing laws, very few countries have enacted leasing laws that encompass "operating leases". Operating leases remain appropriately and adequately covered by the traditional rental law, even though the law(s) covering them will not use that term. ("Operating lease" is an accounting classification term that has no place in the commercial law.)

The Unidroit Convention on International Financial Leasing

A number of countries considering the drafting of a domestic financial leasing law will take into consideration the *Unidroit Convention on International Financial Leasing*, opened for signature in Ottawa in 1988 ("Convention"). While the Convention is applicable only to international, cross-border lease transactions involving lessors, lessees and suppliers in ratifying countries, it has been used as a template for domestic lease legislation in some countries. However, the Convention has come under justified criticism in the several decades since its drafting and while it still has referential value, one must be careful in its use. It has not been widely ratified, and history has not shown it to be particularly relevant. The leasing industry of today is quite different from that of the early half of the 1980s, when the major drafting effort of the Convention occurred. Nevertheless, because it is often mentioned by government

officials and others in connection with the drafting of a leasing law, reference to it is made where appropriate.

The Proper Definition of "Finance Lease" for Commercial Law

There is a tremendous amount of confusion about the true nature of finance leases. Many see them as simply the functional equivalent of loans. While that may be true with the simplest of finance leases, particularly those that are seen when a leasing industry first starts up in a country, that soon ceases to be the case as lessor's become innovative, particularly regarding the end of lease term options that they provide the lessee and the utilization of residual-base pricing. While a finance lease has primarily a financing component, it is not simply financing the ultimate acquisition of the leased asset by the lessee. In fact, the lessee may never acquire ownership of the asset, even though the lessee has a reasonable purchase option to do so.

A finance lease is about financing the use of an asset, not necessarily financing its acquisition.

"The value of a thing comes from its use, not its ownership." –Aristotle.

A financing of the use is necessary or makes economic sense because the use is for a period of time longer than that available on a traditional short-term rental or hire. (Even if a longer term is available from a traditional short-term hire or rental company, the longer-term use payment will almost always be less expensive than repeated short-term charges.)

One-year Reference Mark

Because of their inherent function, finance leases are not short-term. The reference to a non-cancelable term of a year or more will exclude short-term rentals from finance lease treatment. This one-year mark is an industry-evolved standard and a natural separator between transactions which have more of a financing focus and those which have more of a hire focus.

What a Commercial Law Finance Lease Definition Should Not Have: Accounting Criteria

To the extent that the definition in the current Georgian *Law on the Promotion of Leasing* is used for commercial law classification, it is an excellent example of the *wrong* approach, as it essentially incorporates the criteria of IAS 17, the international accounting standard for leases.[7] While these criteria are may be appropriate for financial accounting purposes, they are entirely improper for a commercial law. Accounting and commercial law have very different goals and purposes.[8]

The Two Critical Criteria of a Modern Finance Lease

Two key factors uniquely distinguish financial leasing transactions:

[7] Please see the prior details on Art.3.
[8] Please see the Appendix, "The Leasing Infrastructure Matrix"

(1) lessee's selection of the equipment and the supplier and
(2) lessor's acquisition of the equipment specifically for lease to the lessee.

In fact, these two characteristics comprise the breakthrough concepts that created the modern financial leasing industry 40 years ago. A good leasing law includes those two definitional elements *and no others*. These are the critical characteristics which justify the different set of rights and responsibilities afforded the parties in a finance lease transaction. Accounting classification criteria are irrelevant for apportioning legal rights and responsibilities and should not be used in a commercial law application. Nor, for the same reason, should tax-based criteria be used.

Now, considering each of these two criteria:

(1) "lessee's selection of the equipment and the supplier"
Since the lessor is not generally involved in the selection of the asset or its supplier, it is only fair that he has less responsibility for problems with the asset. After all, the lessee is the one who selected the asset and its supplier. This does not leave the lessee without recourse for asset problems; it just requires that the lessee seek their solution from the supplier rather than from the lessor.

(2) "lessor's acquisition of the asset specifically for lease to the lessee"
It should also be noted that a definition of financial leasing which focuses on the lessee selection of equipment and supplier does not in and of itself preclude the lessee from delegating that authority to the lessor, with the lessor then acting as its agent. Nor does it preclude a supplier from effectively doing finance leases through a wholly-owned financial leasing subsidiary, because that subsidiary, as a separate legal entity, would be an independent third party when it is a lessor.

However, it does mean that only the initial lease of a lease object by the lessor can be classified as a finance lease. In some countries this can create a problematic limitation on meeting the country's lease financing needs. In those instances, this criterion (and the first one too) can be supplemented at the end with the phrase *"provided, however, that a subsequent lease of a lease object from a previous finance lease by the same lessor can still qualify the subsequent lease as a finance lease."* This is done in the Proposed Law for Georgia.

Full-payout Status Is Irrelevant

Although some domestic leasing laws include a reference to "full payout" economics as the classification criteria for determining the laws application, its existence or absence is irrelevant as a basis for determining what are the fair and reasonable rights and responsibilities of the parties to a finance lease transaction. Full payout status has everything to do with how quickly a lessor recovers its asset investment and profit and little to do with whether or not it is fair that the lessor have limited asset responsibilities and that a lessee may have to pay the lease payments even if the asset is not working properly.

A reference to "full-payout" status is usually included in a commercial law because of accounting's perspective that the lease is "loan-like." This concept masks a hidden assumption that all finance leases are really the same thing as loans, and that is simply

not true. Finance leases are a new and unique form of contractual arrangement built upon a variety of economic structures that can be simple or sophisticated. By including a full payout requirement in the definition of a finance lease, finance leases become locked into their simplest, most basic economic structure and are forced to remain the functional equivalent of loans. The development of new leasing products and the growth of the industry become artificially, unnecessarily and unfortunately stymied.

Purchase Options and Renewal Options

Definitional references to purchase options and renewal options are also improper, as their existence can occur in both "finance leases" and "operating leases". Their inclusion as a classification determination element can seriously impair the proper scope of the financial leasing law and impair the development of new products.

The Proper Definition

Thus, the proper definition of a finance lease, *for commercial law purposes*, one that will allow for appropriate apportionment of the parties rights and remedies, is:

"Finance lease" means a lease for an initial non-cancelable term of a year or more in which:

> *1) the lessee specifies the property and selects the supplier without relying primarily on the skill and judgment of the lessor; and*
>
> *2) the property is acquired by the lessor in connection with a leasing agreement for lease to the lessee.*

A lease may be a finance lease without regard to:

> *1) whether or not the lease payments are calculated so as to take into account in particular the amortization of the whole or a substantial part of the cost of the property, or*
>
> *2) whether or not the lessee has or subsequently acquires the option to buy the property or to hold it on lease for a further period, and whether or not for a nominal price or rental."*

There should be no other criteria.

Beyond the Definition of Finance Lease

Once the proper scope of the financial leasing law has been established through the proper definition of finance lease, if the three fundamental drafting principles are followed, i.e.:

> *1. A definition of finance lease that is based on recognition of the three-party structure of modern financial leasing and not one based on accounting or tax classification rules;*
> *2. Duties consistent with each party's role in the transaction; and*

3. *Freedom of contract in negotiating the parties' agreements;*

then a quality leasing law can follow.

The details of a proper and quality leasing law will vary from country to country. The Proposed Law that is part of this Report is specific to Georgia and follows the standards set out in *Drafting a Modern Financial Leasing Law*. (Please see the paper by this title in the appendices.) The details behind each provision are presented as annotations to each article in the Proposed Law.

Bankruptcy

Bankruptcy and insolvency issues are part and parcel of being in the leasing business. Leasing is a part equipment/part credit-granting business where getting repaid is at the core of the business activity. Sometimes that means trying to get repaid in the unfortunate circumstances of a lessee bankruptcy or similar type of insolvency proceeding.

The major issues for a lessor in a lessee bankruptcy are really just two: (1) getting the equipment and (2) getting the money. Both can be a significant problem when a lessee has "filed for bankruptcy."

The key issue for the lessor is "getting the equipment"—quickly. This is accomplished first by clearly excluding the leased equipment from the lessee's bankruptcy estate, and secondly, requiring the lessee to immediately return it to the lessor. If the lessee is going out of business, this creates no problem. If the lessee is attempting to "reorganize" its business under the country's bankruptcy code provisions for such reorganization and needs to continue using the equipment, the practical result is that the lessee continues to pay the lease payments in order to keep possession of it. The Proposed Law addresses these two issues.

As for "getting the money", a lessor stands in line the same as any other creditor.

Repossession

The lessor owns the leased property. It retains the ownership right throughout the lease transaction, even if there is a transfer of the title to the lessee at the end of the lease term through the lessee's exercise of a purchase option or otherwise.

The fact that the property is the lessor's gives the lessor a fair and justifiable right to repossess the property if the lessee defaults. Yet, if the exercise of this right is delayed for any reason, including a slow court system, the lessor may effectively be denied any real recovery. (For a detailed discussion of the issues from an international perspective, please see *Repossession and Leasing* in the appendices.)

The Proposed Law allows for self-help repossession by the lessor unless such action would cause a breach of the peace. In that case, assist of the courts must be obtained. Procedures are established for quick issuance of the order and the prevention of stalling tactics by the lessee.

Lease Registry and Secured Transactions

Georgia has a draft Law on State Registry that seeks to include interests in movables. There is also a drafting effort underway regarding a secured transaction law, which by its nature also would establish a registry for security interests in movables. The most recent draft of this secured transaction law would allow for the registration of leases, accord them certain priorities if the leases are filed and deny certain rights if they are not. However, except for registration and priority issues, leases would remain outside the scope of the secured transactions law. This is appropriate. For a number of reasons, a lease should not be viewed as a secured transaction, especially in a country with a transitioning economy such as Georgia. A detailed discussion of the issues arising between leasing and secured transactions is beyond the scope of the particular project. However, two key points can be made:

> *1) lessors should have a right (but not necessarily the obligation) to register leases in any registry system for movables; and*
> *2) leases should not be considered secured transactions or brought within the general application of any secured transaction law.*

Although the Proposed Law is drafted to take supremacy over any secured transaction law as regards finance leases, any final draft of any secured transactions law must be carefully reviewed and coordinated with the leasing law.

Concluding Comments

Georgia needs a good leasing law if leasing is to grow and prosper in the country and make its maximum contribution to economic development. The Proposed Law can help.

APPENDIX: A

A PROPOSED FINANCIAL LEASING LAW FOR GEORGIA

by S.C. Gilyeart

JD with Honors (Law), BA with Honors (Economics)
Admitted before the US Tax Court

PREAMBLE

Goal of the Law

The goal is the very best leasing law for Georgia, one that accommodates its legal traditions and yet utilizes the best from international experience. And international experience continues to show that there are ways to significantly improve existing leasing laws. This specific proposal seeks to incorporate those advances.

The Unidroit Convention on International Financial Leasing

A number of countries considering the drafting of a domestic financial leasing law will take into consideration the *Unidroit Convention on International Financial Leasing*, opened for signature in Ottawa in 1988 ("Convention"). While the Convention is applicable only to international, cross-border lease transactions involving lessors, lessees and suppliers in ratifying countries, it has been used as a template for domestic lease legislation in some countries. However, the Convention has come under justified criticism in the several decades since its drafting[1] and while it still has referential value, one must be careful in its use. It has not been widely ratified, and history has not shown it to be particularly relevant. The leasing industry of today is quite different from that of the early half of the 1980s, when the major drafting effort of the Convention occurred. Nevertheless, because it is often mentioned by government officials and others in connection with the drafting of a leasing law, reference to it is made where appropriate.

Integration of Current Leasing Law and Previous Drafts

In drafting this proposed new law ("Proposed Law"), the existing *Law of Georgia on Promotion of Leasing Activity* ("the Current Law"), along with the most recent draft being developed by a group lead by the International Finance Corporation ("the IFC Draft"), US AID, GEGI and the existing Georgian lease companies, were reviewed for appropriate inclusion. Applicable sections from the Civil Code and Civil Procedure Code were also considered. Material from international "best practices", other leasing laws, and the consultant's broad and varied experience have also been considered and incorporated.

[1] The main drafting effort occurred in the early and mid-eighties, almost 20 years ago, when the leasing industry was only half the age it is now. The industry has evolved significantly since then.

Absence of Some Existing Provisions

Every provision in every draft and in the Current Law has been considered; however, this proposal may not contain a counterpart for each. The goal of this proposal is to utilize "international best practices" for the maximum benefit of Georgia. That means that this proposal must also be forward-looking, considering not only the current Georgia leasing marketplace but the one that this proposal will hopefully help develop. Accordingly, provisions which might unnecessarily handicap that effort are omitted, especially those that unnecessarily restrict "freedom of contract"—one of the key guiding principles.

Three Fundamental Drafting Principles

The basic structure of a modern lease is quite different from that of a traditional rental, and it needs legal provisions that are often just the opposite of what is appropriate in a rental. For example, under a traditional rental, a lessor would be responsible for equipment defects; under a modern lease, the lessor would not, as the lessee would have chosen the equipment and the supplier and will usually know much more about the equipment than the lessor. The supplier is a critical third party in a modern lease. This fact needs to be recognized and the duties assigned by the law need to be consistent with each party's role in the transaction.

Moreover, the law should be just a fall-back framework for parties who fail to cover a topic in their lease agreement or when the provision that they have just does not work in the particular circumstances that occurred. It should not mandate provisions that cannot be changed by contract, and if it does, it should be very explicit that those provisions cannot be changed by the parties' agreement. Freedom of contract must be paramount.

Thus, a good modern leasing law follows three fundamental principles:

1. *A definition of finance lease that is based on recognition of the three-party structure of modern financial leasing and not one based on accounting or tax classification rules;*
2. *Duties consistent with each party's role in the transaction*
3. *Freedom of contract in negotiating the parties' agreements*

Integration into the Civil Code

Even with a leasing law written so that it can be enacted as a stand-alone law or decree, as this one is, provisions covering the rights and responsibilities of the parties to a leasing transaction properly belong in the Civil Code in the Part that addresses specific kinds of contracts. Thus, ultimately, the leasing law's provisions should become amendments to the Civil Code under a Chapter heading of "Leasing." Nevertheless, if the process, either theoretical or practical, for amending the country's Civil Code is difficult or protracted, enactment of a special law may be advisable on the basis of expediency. Ultimately, all commercial law rules, including those governing leasing, should be in one place—and that is almost always the Civil Code.

About Translation

It must be recognized that this proposal uses a copy of the Current Law and drafts that were translated into English. This proposal in English will of course have to be translated back into Georgian. In dealing with legislation, specific word choice, grammatical construction and punctuation can make a huge different in meaning, interpretation and consequence. Translation puts all of these at unavoidable risk. However, to reduce that risk, this proposal stays with the literal translation as received and utilized, even if this makes the wording in some of the articles in this proposal awkward. Nevertheless, it is sincerely hoped and expected that the intent and meaning of each provision will come through clearly.

Organization of this Proposed Law

This Proposed Law is organized in Four Basic Parts:

Part I—Purpose, Scope and Definitions
Part II—The Lease Agreement
Part III—Rights and Obligations of the Parties
Part IV—Concluding Provisions

The Part on Rights and Obligations of the Parties is further organized by Lessor, Lessee, Supplier and Other Parties. This approach best accommodates the drafting principle of "*duties consistent with each party's role in the transaction*". This approach is preferred to the somewhat common approach of transitioning countries to first state what is mandatory then state what is permissible, and then what is not permissible. That approach is less accommodating of the drafting principle of "*freedom of contract in negotiating the parties' agreements.*" Some leasing laws will organize their articles by subject matter, e.g. insurance, repairs, etc. rather than party by party. That approach makes it harder to find who does what. For these reasons, if this Proposed Law should become a part of the Civil Code, it is highly suggested that the organizational format used in this Proposed Law be retained as much as possible, even as some expense to traditional Civil Code presentation. The Part on The Lease Agreement collects those articles that relate more to the lease agreement itself and are generally party neutral. Part I on Purpose, Scope and Definitions covers just what it describes. Part Four can be used to handle legislative enactment details according to Georgian law and legislative customs if this Proposed Law is indeed presented as a Special Law; some internationally typical and important items are already included.

(Please note: Some articles may not have specific comments below them as the articles are self-explanatory or the comments are best organized to cover several of the articles gathered above as a group.)

PART I

PURPOSE, SCOPE AND DEFINITIONS

Article 1. Concept

Under a finance lease contract a lessee acquires the use of a property for a period of at least a year. While the finance lease contract may have a financial component, the lessee may or may not ultimately acquire the property. The lessee is financing the use of the property, not its ownership.

Comment. A particular finance lease may or may not be the functional equivalent of a loan. The fundamental concept is financing the use of an property, not its ownership—a use that is for a longer term than with a traditional rental. Any approach that conceptualizes a finance lease as a purchase on installments is fundamentally flawed and will lock the leasing industry into the simplest lease product that is functionally no different from a commercial loan. Leasing will be prevented from adding something new and valuable from to the country's economy.

Please note that this first article titled "Concept" in is accord with the first article in the specific contract chapters of the Civil Code.

Article 2. Definitions

Comment. While a list of definitions is uncommon at the beginning of a Special Part of a Civil Code, this approach is the clearest, cleanest and most functional for legal rules for such a confused, misunderstanding area as leasing. While it is certainly appropriate in a free-standing law, this organizational approach may need to be adjusted when these articles are used as amendments to the Civil Code. In any event, the actual, substantive language used here needs to be preserved intact.

1. "Advance lease payments" are any number of periodic lease payments that are paid by the lessee at or before the inception of the lease. Advance lease payments are not a security deposit.

Comment. Many lessors will structure a lease with advance payments, such as "first and last," or "first and last two," or "first two and last three." (There are a number of possibilities.) Advance payments are not a security deposit. Once paid, they are fully the property of the lessor, and the number of lessee's total lease payments has been reduced by that amount. (For example, if the lease is 36 months, with "first and last", the lessee now only has 34 payments remaining.) Advance lease payments do not perform the role of a security deposit; they are not "extra money" available to apply to the cost arising from the lessee's failure to pay the remaining lease payments or the expenses of default. They have already been credited to the lessee's account. Advance lease payments are used instead to adjust the internal rate of return of the lease transaction.

2. "Finance lease" means a lease for an initial non-cancelable term of a year or more, in which:

1. **the lessee specifies the property and selects the supplier without relying primarily on the skill and judgment of the lessor; and**
2. **the property is acquired by the lessor in connection with a lease contract for lease to the lessee;**
   Provided, however, that a subsequent lease of a lease object from a previous finance lease by the same lessor can still qualify the subsequent lease as a finance lease.

A lease may be a finance lease without regard to:

a. **whether or not the lease payments are calculated so as to take into account in particular the amortization of the whole or a substantial part of the cost of the property, or**
b. **whether or not the lessee has or subsequently acquires the option to buy the property or to hold it on lease for a further period, and whether or not for a nominal price or rental."**

Comment. The definition of what constitutes a finance lease is critical, as it sets forth the parameters of the transactions which will be covered by the law and sets forth the controlling characteristics of a lease relationship that is fundamentally different from that of a traditional rental or hire.

There is a tremendous amount of confusion about the true nature of finance leases. Many see them as simply the functional equivalent of loans. While that may be true with the simplest of finance leases, particularly those that are seen when a leasing industry first starts up in a country, that soon ceases to be the case as lessor's become innovative, particularly regarding the end of lease term options that they provide the lessee. While a finance lease has primarily a financing component, it is not simply financing the ultimate acquisition of the leased property by the lessee. In fact, the lessee may never acquire ownership of the property, even though the lessee has a reasonable purchase option to do so. A finance lease is about financing the *use* of an property, not financing its *acquisition*. A financing of the use is necessary or makes economic sense because the use is for a period of time longer than that available on a traditional short-term rental or hire. (Even if a longer term is available from a traditional short-term hire or rental company, the longer-term use payment will almost always be less expensive than repeated short-term charges.)

Because of their inherent function, finance leases are not short-term. The reference to a non-cancelable term of a year or more will exclude short-term rentals from finance lease treatment. This one-year mark is an industry-evolved standard and a natural separator between transactions that have more of a financing focus and those which have more of a hire focus.

Sections 1 and 2 set forth that which is unique to financial leasing transactions: (1) the lessee's selection of the equipment and the supplier and (2) the lessor's acquisition of the property specifically for lease to the lessee. In fact, these two characteristics comprise the breakthrough concepts that created the modern financial leasing industry 50 years ago. *A good leasing law includes those two definitional elements and no*

others. These are the key characteristics that justify the different set of rights and responsibilities afforded the parties in a finance lease transaction. Since the lessor is not generally involved in the selection of the property or its supplier, it is only fair that he has less responsibility for problems with the property. After all, the lessee is the one who selected the property and its supplier. This does not leave the lessee without recourse for property problems; it just requires that the lessee seek their solution from the supplier rather than from the lessor.

It should also be noted that a definition of financial leasing which focuses on the lessee selection of equipment and supplier does not in and of itself preclude the lessee from delegating that authority to the lessor, with the lessor then acting as its agent.

The “Provided, however” provision allows for subsequent leases by the same lessor to still quality as finance leases. While this addition is not conceptually correct, it is appropriate in some countries as a practical expediency. This is usually necessitated by a severe lack of secondary markets in conjunction with an unfortunate cross-contamination of commercial law, tax law and accounting rules from a unitary “finance lease” label. Such is the situation in Georgia at the present time.

Although the Convention and many domestic leasing laws include a reference to a common finance lease circumstance that, in the words of the Convention, "the rentals payable under the leasing agreement are calculated so as to take into account in particular the amortization of the whole or a substantial part of the cost of the equipment", this reference to "full payout" economics has been heavily criticized and is unsound. The existence or absence is irrelevant as a basis for determining what are the fair and reasonable rights and responsibilities of the parties to a finance lease transaction. Full payout status has everything to do with how quickly a lessor recovers its property investment and profit and little to do with whether or not it is fair that the lessor have limited property responsibilities and that a lessee may have to pay the lease payments even if the property is not working properly.

The reference to "full-payout" status is usually included because it indicates that the lease is "loan-like." This concept masks a hidden assumption that all finance leases are really the same thing as loans, and that is simply not true. They are a new and unique form of contractual arrangement built upon a variety of economic structures that can be simple or sophisticated. By including a full payout requirement in the definition of a finance lease, finance leases become locked into the simplest economic structure and are forced to remain the functional equivalent of loans. The development of new leasing products and the growth of the industry become artificially, unnecessarily and unfortunately stymied.

A definitional reference to purchase options is also improper, as their existence can occur in both “finance leases” and “operating leases”. Their inclusion as a definitional element can impair the proper scope of the financial leasing law and impair the development of new products. This fact is recognized in the Convention's provision that *"This Convention applies whether or not the lessee has or subsequently acquires the option to buy the equipment or to hold it on lease for a further period, and whether or not for a nominal price or rental."*

3. "Lease" means a transaction in which a lessor enters into an agreement with a lessee in which the lessee is granted the right to possession and use of property for a term in return for the payment of periodic lease payments or their equivalent. "Lease" shall include a sub-lease.

Comment. This basic definition of a lease is the historical definition, which goes back over 4000 years. It is the fundamental definition of a lease in use in almost every jurisdiction in the world. It establishes in a general way the types of transactions that will be subject to the provisions of this law.

Sub-leases are included in the term "lease" as they are simply a lease-within-a-lease. The inclusion of sub-leases is also necessary to encompass subsequent transfers of the right to possession and use of real estate when the initial lease is from the State, which is often the case in a centrally planned economy transitioning to a market economy.

This provision carries no implication that subleasing in allowed; almost all leases will prohibit it without the lessor's prior written consent. Rather, this provision provides the same legal framework for a sublease that exists for leases in general. Please note that this provision does not require that a sublease be no longer than the lease "above it" ("superior lease). There can be legitimate circumstances where a lessor will allow a sublease that extends the original term of the superior lease, particularly when the original lessee faces financial difficulties within the last year of its lease. A really short sublease is usually economically unjustified.

The term "agreement" is used in this Proposed Law rather than the term "contract". In some countries, the term "agreement" is more encompassing than the more limited term "contract".[2] The translation of the Civil Code provided use the word contract, but it is unknown whether or not that is the original word in Georgian. To minimize the risk of an unintended consequence, the word agreement is used here. It can be replaced with "contract" if that is more appropriate Georgian term.

4. "Lessee" means a person, natural or legal, who receives the right to possession and use of an property from a lessor.

Comment. A lessee can be either a natural or legal person. In fact, it is particularly desirable that small businesses, many of which may be family operations or which otherwise may not be formed as a company or legal enterprise, qualify for lease transactions. Leasing can do the most for a country's economy when it reaches the SME sector, invariably the most productive part to the national economy.

5. "Lessor" means a person, natural or legal, who transfers the right to possession and use of an property to a lessee.

Comment. The definition of lessor intentionally includes natural persons within its scope so that if such a person enters into a lease, even if improperly, there still exists a set of rules for determining the rights and responsibilities in such a transaction and the consequences thereof. Whether or not it is permissible for individuals to engage in

[2] For example, an "agreement" may not be valid as a "contract" if it has not been notarized or if a document or stamp tax has not been paid, or it may be valid for some purposes and not others.

financial leasing will depend upon what licensing and supervisory scheme, if any, the country may impose on financial leasing.

6. "Property" means any type of property, movable or immovable, which may be the subject of a lease.

Comment. The term "property" is intentionally used rather than the more specific "equipment" to allow for the financial leasing of real estate and other immovables. (It is also preferred over the somewhat commonly used "leased object.") While it is generally advisable to have separate rules for real estate leasing and for leasing of movables such as equipment, such a division is not always appropriate in a particular country. Financial leasing of immovables and real estate is also encompassed within the Convention and the leasing practices and laws of many countries, particularly Eastern Europe. If it is later determined that immovables and real estate transactions should be treated separately, they may subsequently be the subject of their own law without prejudice from this one. If it is the public policy of the country to not allow the leasing of land, the definition of "property" can be modified to exclude it. The IFC Draft also allowed finance leases to include immovables.

7. "Security deposit" means an amount identified in a lease agreement as an amount paid by the Lessee to be held by the Lessor as security for the full and timely performance by the Lessee of all of its obligations under the Lease Agreement.

Comment. Most leasing laws do not include a definition of "security deposit"; the matter of security deposits is a detail for negotiation at the specific lease transaction level. However, Georgia has some special rules regarding security deposits that create problems. To deal with those problems, this Proposed Law has an article on security deposits (and advance lease payments); hence this definition. The IFC Draft also provides a definition of security deposit in a form identical in substance to the definition above.

8. "Supplier" means a person, natural or legal, from which a lessor acquires property to be leased to a lessee. The lessor's acquisition may be by purchase, lease, assignment of a right to purchase or lease, including by assignment from the lessee. The lessee may be a supplier in a sale-leaseback transaction.

Comment. A lessor can acquire properties for lease in several ways. The two most common are to (1) buy the property directly from a manufacturer, distributor, retailer or other regular seller of the property, at the request of the lessee when the lessee has not yet entered into a purchase agreement with the supplier; and (2) to take an assignment of a purchase agreement when such an agreement has already been negotiated between the lessee and the supplier. Another common and valuable approach is for the lessor to buy properties that the lessee already owns and then lease them back to the lessee ("sale-leaseback"). This law specifically authorizes sale-leaseback transactions, a valuable tool in providing new working capital to a lessee and in revitalizing stagnant industrial sectors. Special provisions for sale-leasebacks are not needed. For commercial law purposes, they are really two separate, sequential transactions: (1) first, the sale by the lessee to the lessor, and then (2) the lease by the lessor to the lessee. Sales law should apply to the first transaction, lease law to the second. Moreover, the lease transaction may or may not be a finance lease; it could be a rental (or what some

would consider an “operating lease”). It does not follow in concept or practice that the lease-back will be a finance lease. (In fact, when the world’s airlines did sale-leasebacks of their aircraft fleets in their 1980s to free up much needed capital, most of the lease-backs were not “finance leases.”)

9. "Supply agreement" means the agreement by which the lessor acquires possession and use of the property to be leased to the lessee.

Comment. The phrase "acquires possession and use" is used intentionally in place of "acquires ownership" to accommodate the lessor's acquisition by sublease rather than purchase, as well as acquisition by purchase. This is important to accommodate future lease industry developments that will use a tiered series of lease arrangements to facilitate more sophisticated funding structures for the lessor, and a lower cost of funds for lease transactions.

10. "Term" means the period of time specified in the lease agreement in which the lessee is allowed the possession and use of the leased property.

Comment. The "term" of the lease is the period specified in the lease agreement, including any periods of renewal, extension, grace or other allowance also specified in the lease agreement. It does not include unauthorized retention of the leased property in violation of the lease agreement.

Article 3. Scope; Conflicts with Other Law

1. Scope; Conflicts with Other Laws

This law applies to finance leases and shall be controlling over any other law or regulation in conflict with it, including without limitation, any bankruptcy law, secured transaction law, product liability or owner liability law or article of the Civil Code.

Comment. This law is designed to provide a complete treatment for financial leases within the topics it covers. It is to take precedence over any other law or regulation that might appear in conflict with it.

It is not at all uncommon for a transitioning or developing country to have two or three laws, decrees, Civil Code provisions, ministerial regulations and the like covering financial leasing, leading to a great deal of confusion as what the actual rules are. These situations do not necessarily happen intentionally but rather through delay, inadvertence, inattention or governmental focus upon other, more urgent matters. This Article makes it explicit that this law controls, without the necessity of having to wait for legislation to be repealed, rescinded or amended.

2. Freedom of Contract

Unless this law specifically states that a provision is mandatory, the agreement between the parties may differ from the provisions of this law and even be contrary to what is otherwise provided in this law.

Comment. "Freedom of contract" is one of the three fundamental drafting provisions behind this law. Only in those instances which this law specifically makes a provision mandatory (e.g. Art. 4 In Writing, Art. 5 Minimum Lease Payments) may these provisions not be varied. In all other instances, this law is designed to provide a rule where an agreement is silent, ambiguous, or unclear. Otherwise, the provisions of the agreement between the parties shall prevail.

PART II

THE LEASE AGREEMENT

Article 4. Form of Agreement

The finance lease agreement shall be in a writing signed by the lessor and the lessee and shall set forth the terms and conditions of the parties with respect to the leased property.

Comment. Lease agreements are usually in writing, and should be required to be in writing, as is being temporarily transferred to the use and possession of another. In such a circumstance, it is too easy to have confusion about the obligation to care for it and to return it.

Article 5. Minimum Lease Provisions

An agreement shall be sufficient as a lease agreement if it provides at least:

a) a description of the leased property or properties;

b) the amount, periodicity and term of the lease payments;

c) a commencement date; and

d) the signatures of Lessor and Lessee.

No other provisions are mandated unless specifically required elsewhere in this law.

Comment. One of the major problems with many leasing laws is that they include a long list of provisions that must be included in the lease, including insurance, handling of risk of loss, end of term options (e.g., purchase options, renewal options, automatic transfers of title, etc.), frequently making the lease agreement null and void if one provision is missing. This is neither necessary nor appropriate. Although the leasing industry worldwide has developed a lease agreement that covers more or less the same topics, regardless of the country, the specific details are still a matter for negotiation of the parties. If they missing something important, the agreement should not be invalid as a result. The only exception is for those things that without them, it is not possible to know that there was some kind of agreement in the first place, nor what it is fundamentally about. The list in this article covers those items.

Article 6. Security Deposits; Advance Lease Payments

A lease agreement may provide for a security deposit, advance lease payments, or both. A security deposit may or may not earn interest on behalf of the lessee, as specified in the lease agreement, and may be returned or applied by lessor as specified in the lease agreement. In the absence of a provision covering the handling of a security deposit, a security deposit shall not earn interest and shall be returned to lessee after full and timely performance of lessee's lease obligation. Advance rental payments shall not earn interest. Security deposits and advance rentals may be in any amount as negotiated by the parties.

Comment. Security deposits and advance lease payments are not the same thing; they do not perform the same function. A security deposit provides "extra money" over and above the promised periodic lease payments, to cover losses, damages and other costs from a lessee default. Advance rentals are an immediate credit in payment of those periodic lease payments and a reduction in the remainder owned. Advance rentals are immediately the property of the lessor, while a security deposit may be returned to the lessee upon full and timely performance of its lease obligations. A security deposit provides security; advance lease payments adjust the internal rate of return of the lease transaction. Because of these different purposes, they both need to be allowed.

It is also reported that existing law in Georgia effectively limits security deposits to three payments and would automatically consider any advance lease payments a security deposit returnable to a lessee. This is an unnecessary restraint that will hinder the development of a broader range of lease products. The last sentence of this Article, in conjunction with the supremacy article (Article 3 of this Proposed Law), will override that other law for finance leases.

Article 7. Labels

If the lease agreement provides that the properties be labeled as owned by lessor or subject to a lease from lessor, such labels shall not be removed or rendered illegible by anyone other than the lessor or its authorized agent; any removal by any other party or person shall be an offence under the [Criminal Code] of Georgia at the [appropriate misdemeanor or felony level for a theft of properties of the value of the leased properties from which the label or labels were removed]. Any damage to such labels which make them illegible shall be immediately reported to the lessor by lessee upon discovery or lessee shall be liable to the same extent as if the lessee had removed them without authorization. A lessee shall not be liable under this article if after timely lessee notice to the lessor, the lessor shall have failed to replace such labels within a reasonable time.

Comment. Many lease agreements require that the leased properties be labeled as "Leased from XYZ Lease Company". This is even in cases where there are well-established registries for the properties, such as airplanes and tractor-trailer rigs. In a country that has no effective lease registry, labels may be the only means of putting others on notice that the lessee does not own these properties that it happens to possess. In those countries, labels play a critical role. Unfortunately, many lessees prefer to appear more "successful" by giving an appearance of "owning many things", passively or even actively deceiving others, such a bankers looking for available collateral to

secure a loan request. In short, lessees will remove the labels, even if it is a breach of the lease. Without a criminal penalty, there is no practical deterrence. For this reason, some countries, Indonesia for example, make the removal of a lease label a criminal offense. Such a provision is appropriate for Georgia at the present time.

Article 8. Non-monetary Settlement of Accounts

If lessor and lessee agree to the settling of accounts by non-monetary methods, such as by means or production, barter or similar transfers, the value of the non-monetary payments shall be determined by the market value of such items, unless the parties specify in the lease agreement or otherwise, a different mechanism.

Comment. In some countries, particularly within the CIS, lease payments are often made on a barter basis. This provision from the IFC Draft accommodates that practice.

PART III

RIGHTS AND DUTIES OF THE PARTIES

Comment. A modern financial lease transaction has three principal parties--the lessor, lessee and supplier—each of who has a specific role and who should have rights and obligations consistent with that role. A lot of the confusion that exists in the legal environment of many countries occurs because it is not acknowledged that the role of the parties in a finance lease is different than that of their role in a traditional rental. A good leasing law can clarify what those rights and responsibilities are in accordance with their development in the marketplace. The proposed leasing law has sections that address the rights and obligations of each of these three parties, as well as third parties that might be affected by the finance lease contract.

Article 9. Rights and Obligations of the Lessor

1. Lessor's Ownership Right

The ownership right in the leased property shall remain with lessor at all times during the lease term and thereafter until evidenced by a bill of sale to lessee or other party.

Comment. The lessor's ownership of the leased property is paramount in a lease transaction. It shall not be abridged under any circumstance without clear evidence that it has been transferred.

2. Lessor's Duty to Pay for the Property

The lessor has a duty to pay for the property once the lessee without condition or reservation has accepted it.

Comment. The payment of the supplier for the leased property is the primary obligation that the lessor has under a finance lease. In fact, once that payment has been made, the lessor in a typical net term finance lease has performed all of its obligations under the finance lease except to warrant the lessee's quiet use and possession of the property during the lease term.

3. Lessor's Warranty of Quiet Use and Possession

Provided the lessee is not in default, he lessor warrants the quiet use and possession of the leased property by the lessee for the lease term to be free from interference by the lessor or from causes due to lessor's fault.

Comment. The main thing that the lessee is paying for is the use and possession of the leased property for the lease term. If it does not receive that, the lessee does not receive "the benefit of its bargain." It is fundamental that the lessor do nothing to jeopardize that undisturbed use and possession. Of course, if the lessee has caused the problem, then the lessor is not responsible. Nor is the lessor restrained from repossessing its property if the lessee is in default. Repossession and inspections are not violations of this warranty.

"Quiet use and possession" is similar to the entitlement that comes from the civil law's possessory right. However, please note that this warranty does not make lessor responsible for all interference, only that from "lessor or from causes due to lessor's fault."

4. Lessor Not Liable to Lessee Regarding the Property

The lessor shall not be liable to the lessee in any respect of the property except to the extent that the lessee has suffered loss as a result of the lessor's intervention in the selection of the property or in the specification of the property.

Comment. The lessor should not be liable for any problems with the property once the lessee has accepted it. After all, the lessee selected both the equipment and the supplier. In fact, the lessee will most likely know more about the equipment than the lessor. Additionally, the equipment is usually delivered directly to the lessee, inspected by the lessee and accepted by the lessee without the lessor ever having seen it. The lessee is the one in the best position to determine whether the equipment is as ordered and working properly for its intended uses. To make the lessor responsible for equipment defects in such a situation is unfair.

The removal of lessor responsibility for equipment defects does not leave the lessee without recourse—it simply has to seek redress for those problems from the supplier, the proper party for dealing with them and the one in the best position to affect a solution. The Convention also makes the supplier directly responsible to the lessee,[3] as does this Proposed Law.

If the lessor has chosen the supplier and the property, then it might have some such responsibilities. This does not preclude the lessee from nominating the lessor as its

[3] The Convention provides: "The duties of the supplier under the supply agreement shall also be owed to the lessee as if it were a party to that agreement and as if the equipment were to be supplied directly to the lessee. However, the supplier shall not be liable to both the lessor and the lessee in respect of the same damage." Article 10.1.

agent to act in its stead. In that instance, the actual lessor responsibility would depend on the scope and provisions of the agency agreement.

5. Lessor Not Liable to Third Parties

The lessor shall not, in its capacity as lessor or owner, be liable to third parties for death, personal injury or damage caused by the leased property.

Comment. The lessor is not the one using the property; it has specifically given that ability to the lessee, along with the obligation to repair and maintain it and keep it in good working condition. It is therefore fair that the lessor not have responsibility for any harm that the leased property might cause simply because the lessor is a lessor or owns it.

6. Lessor's Rights upon Default by Lessee

In the event of a default of the lease agreement by the lessee, the lessor shall have in addition to such rights as provided by the lease agreement, the following rights:

a. the lessor may recover accrued unpaid lease payments, together with interest and damages.

b. where the default is substantial, the lessor may also require accelerated payment of the future lease payment, may terminate the lease agreement, and may recover possession of the leased property. The default shall be considered substantial if:

(1) the lessee does not pay the lease payments pursuant to the lease agreement for two consecutive rent payment periods;
(2) the lessee breaches any other provision of the lease agreement and fails, after receipt of a written notice from the lessor to remedy such breach within ten (10) days;
(3) the lessee has removed the property from its approved location or has subleased the property without the lessor's prior written consent;
(4) the property is in danger of being damaged or destroyed;
(5) the lessee has a guarantor who is insolvent, bankrupt or dissolved and the lessee has failed to find a substitute guarantor acceptable to the lessor within thirty (30) days of a written demand by the lessor to do so; or
(6) the lessee is insolvent, bankrupt, dissolved or dies.

If the lease agreement is terminated prior to its expiration, the lessor may recover possession of the leased property without having to go to court if such action would not cause a breach of the peace.

In all cases, lessor may recover such damages as will place the lessor in the position in which it would have been had the lessee performed the lease agreement in accordance with its terms, including the additional costs caused by the default, such as collection and repossession expense, court fees, attorney fees, repair and remarketing costs and similar such expenses; the lease agreement may provide for the manner in which such damages are to be computed and such provision shall be enforceable between the parties unless it would result in damages substantially in excess of those which will place the lessor in the position in which

it would have been had the lessee performed the lease agreement in accordance with its terms.

Upon recovery of the property after a termination of the lease agreement, lessor may sell, re-lease or otherwise dispose of the property as it determines in its own best interests, and shall have no specific duty to account to lessee in any way beyond the constraint that it may not ultimately recover from lessee damages substantially in excess of those which will place the lessor in the position in which it would have been had the lessee performed the lease agreement in accordance with its terms. After lessor's termination of the lease and recovery of the property, lessee shall have no right to demand its return to lessee or any reinstatement of the lease.

The lease agreement additionally may impose penalties to the fullest extent allowed by Georgian law.

Comment. One of the most important things a leasing law can do is to provide a rights and remedies scheme for leases that fall into default. *This is not to say that the legislative scheme should supplant the one provided by the parties in their contract*. Rather, as a practical matter it can provide a reference for judges and other dispute adjudicators as to what is appropriate and acceptable in the case of finance leases. Without such a reference, judges have been known to apply traditional rental default remedies-regardless of what the contract says--which are very inappropriate and inadequate for finance leases. Almost every country has experienced this problem as its leasing market has developed.

The Convention provides one generally accepted remedies scheme, and that scheme has essentially been incorporated into this Proposed Law, with some modifications to address some of the criticisms of the Convention that have arisen over the years.

One of the criticisms is that the concept of "substantial default" is not defined. This proposed law provides such a definition. The most serious default is the lessee's failure to pay rent. The "two payment rule" used in the law in not an uncommon industry practice and has been proposed as a standard in other domestic leasing law legislation. For other defaults, the lessee must be given notice and an opportunity to cure the defaults before they can be considered substantial. This also is in accord with general industry practice in most mature leasing markets.

This Proposed Law, as well as the Convention, allows for acceleration of the remaining lease payments. The ability to accelerate the remaining lease payments is important because the lessor would not have acquired the leased property but for the lessee's request. Because there may not be any secondary market for the equipment, repossession of the equipment and a generalized calculation of damages is often a wholly inadequate remedy. A lessor will suffer significant losses in such circumstances. This is very often the case in emerging economies where there are minimal or no secondary markets for almost all types of properties. The more appropriate remedy in such circumstance is to allow the lessor to recover all of the lease payments. Such a remedy would be allowed in the case of a loan, and as a simple finance lease serves a similar financing purpose, such a remedy is appropriate in the case of a finance lease as well. The acceleration of all remaining payments into a currently due lump sum is fair.

Most Civil Codes require that the lease contract will be terminated before the lessor pursues repossession. Repossession is a remedy in addition to recovery of damages. The lessor is still not able to get an excess recovery, because of the limitation to the "benefit of the bargain." This limitation also prevents an excess recovery by lessor when it both accelerates lease payments and recovers possession of the leased property, as a proper credit must be given. *However, this does not require lessor to forfeit any residual interest it had in the property under the terms of the lease agreement.* This point will become more and more critical as lessors do leases with residual based pricing. Such property interest and the value it represents was never an interest of the lessee to begin, and to allow the lessee to use the lessor's residual interest to reduce lessee's obligation would be grossly unfair and improper. That is why this provision in no way provides that lessor must "pay any excess over the lease obligation" to lessee. Such a provision would severely limit the type of modern lease products that can develop, keeping them the simple equivalent of a commercial loan, and has no place in this or any other modern financial leasing law.

The "benefit of the bargain" limitation is included in recognition of the general legal principle that parties should usually not be allowed to structure their contracts so that they make substantially more money from having them default than is made from having them performed as agreed, although a reasonable penalty may effectively result from the damages calculation or separately imposed. Penalties are not damages and serve a different purpose in the law in general. The last part of this article accommodates penalties, a common feature of civil law.

Please note that this article does not contain any provisions regarding what the lessor does with the leased property if it should recover it. Specifically, the lessor has no obligation to sell it, re-lease it, or otherwise dispose it. No express "credit" is mandated. For one thing, the circumstances are too varied to be properly addressed in the law. But more importantly, it is the lessor's property. And the lessor needs maximum flexibility to try and reduce its losses from the lessee's default. Moreover, the "benefit of the bargain" limitation still applies.

7. Indemnification

The lessor has the right to require that the lessee indemnify the lessor from any and all loss, claims, damages or other consequences arising from or in connection with the lessee's use and possession of the leased property.

Comment. Most lease contracts provide for indemnification of the lessor. This provision makes clear that such provisions are allowed, as they are often poorly understood. This reference should not in any way be taken as a requirement that every typical lease agreement provision needs to be mentioned in this proposed leasing law to be acceptable. The IFC Draft has an equivalent article.

8. Insurance

The lessor may require that the lessee obtain, maintain and pay for liability and casualty insurance covering the leased property during all times that it is in the possession or control of the lessee until the leased property has been returned to the possession and control of the lessor, even if the lease term has come to an end or the lease agreement has been earlier terminated. Notwithstanding any other

law to the country, both the lessor and lessee shall have an insurable interest and either or both may be beneficiaries as provided in the lease agreement. If lessee is obligated to obtain and pay for insurance, and fails to do so, lessor has the right but not the duty to obtain such insurance and lessee shall immediately reimburse lessor for all costs incurred in during so.

Comment. Some leasing laws require that the lessee provide and maintain insurance covering the leased properties. Although the insurance industry is often only modestly developed in transitioning or developing economies, insurance remains important, and if and when it is available, the lessor may properly require it. This provision is also designed to address some of the technical legal difficulties that can occur with respect to insurance if the lease agreement has legally been terminated or has come to an end but the equipment has not yet been returned or just who has insurable interests in the case of a finance lease. An absence of insurance coverage requires immediate attention; the last sentence provides explicit approval of an expedient remedy to obtaining coverage and conforms to standard lease agreement provisions and industry practice. The IFC Draft has a comparable provision, but with more involved detail.

9. Inspection

Lessor shall have the right to inspect the leased property during normal business hours at all times during the term of the lease and until the property is returned to the lessor after the end of the lease. Such inspection shall not be considered to any way interfere with lessor's warranty of quiet use and possession nor to interfere with any aspect of lessee's possessory right.

Comment. The lessor's right to inspect its property in the hands of the lessee to make sure that it is being properly used, maintained and otherwise well-taken care of is fundamental to the nature of leasing. This provision makes clear that the exercise of this right does not violate the lessor's warranty of quiet use and possession (Art. 9.3) or any aspect of lessee's possessory right under civil law.

10. Attachment and Removal of Leased Property

Lessor shall remain the owner of the leased property at all times, regardless of the extent of any attachment to or incorporation as part of any other movable or immovable property, even if removal of the leased property would cause irreparable damage to that other property. Lessor shall have no liability for any damage or other harm caused by such removal.

Comment. This provision is necessitated by Civil Code Art. 150, is in accord with standard leasing industry practices and leasing agreement terms, and is necessary to protect lessor's ownership right. It is similar to a comparable provision in the IFC draft.

11. Lessor Bankruptcy

In the case of Lessor bankruptcy, lessor's creditors and other interested parties shall have no rights in connection with the lessor's lease agreements than the lessor has pursuant to such lease agreements.

Comment. Absent outright fraud, lessor bankruptcies are extremely rare, even in developing and transitioning economies. There are many reasons for this, including the oversight performed by lessor's funding sources when they agree to fund various lease transactions. Even when they do occur, the lessee's lease interests are not in realistic jeopardy. The last thing that a bankrupt's creditors want to disturb is a steady stream of cash payments, such as those coming in under a lease. Nor do they want the hassles of dealing with a bunch of used equipment. In practice, lessor bankruptcies have no visible effect on lessees beyond possibly having to send their monthly payment to a new address. Still, this provision makes clear that the lessor's creditors have no greater rights in connection with the lease than the lessor has.

Article 10. Rights and Obligations of the Lessee

1. Acceptance

a. Lessee's Duty to Accept

A lessee has a duty to accept the leased property if it is timely delivered and conforms to the supply agreement. If the leased property is not delivered or is delivered late or does not conform to the supply agreement, then at or before the time for acceptance, but not after:

(1) the lessee has the right to reject the property, demand from the supplier the immediate cure of its defect or defects, or to terminate the lease agreement, but shall have no right to terminate, rescind or modify the supply agreement without the consent of the lessor; and

(2) the lessor has the right but not the responsibility to remedy the supplier's failure to tender the property in conformity with the supply agreement.

b. Means of Acceptance

Acceptance may be by execution of a document acknowledging acceptance or by other means. Without limiting what may constitute other means, other means include:

(1) lessee by its actions with respect to the leased properties has indicated that the properties are acceptable, whether with non-compliance with the supply agreement or without;

(2) lessee has failed to give timely notice to lessor and supplier of specific non-compliance with the supply agreement, where the supplier or lessor could have timely cured the non-compliance had they been given timely notice;

(3) lessee has failed to give notice of rejection of the properties within five (5) business days after the lessee discovered or should have discovered the non-compliance.

c. Deemed Acceptance

The lease agreement may provide that lessee shall be deemed to have accepted the property unless lessor receives a written notice of lessee's rejection, detailing the specific reasons for rejection, with a specified period of time not less than ten (10) business days' after lessee has received the properties.

d. Acceptance Abroad or Before Delivery

The lease agreement may provide that lessee shall be deemed to have accepted the property while it is still abroad, before it is delivered to and inspected by lessee or upon lessor's payment of the supplier for it.

Comment. The lessee has a duty to accept the property if it is what the lessee ordered and it is free from defects, and it is delivered on time. If it is not, it can reject the property; but once it has accepted the property, it cannot revoke that acceptance, as the lessor will most likely have already paid for it. It cannot change the supply contract without the lessor's consent, and the lessor has the right but not the obligation to do what the supplier should have done right in the first place.

Typical lease industry practice uses an acceptance document signed by the lessee as evidence that the lessee has accepted the properties for all purposes of the lease. Yet, there have been more than a few instances where lessee's have refused to sign such a document but nonetheless have starting using the properties and reaping their benefit. Lessees have also been known to fail to timely inspect the leased properties for defects or other non-compliance, but still later claim to have found a problem that should have been discovered at the beginning. The provisions in this article address some of these common problems, but this is not exhaustive coverage. Delivery and acceptance practices are driven by the specifics of particular transactions, and there is a wide variation in how lease transactions come together. The leasing law cannot cover them all, nor should it even try. Too much detail in this area can handicap the flexibility that is the hallmark contribution that leasing makes to the country's economy.

The last provision on acceptance abroad or before delivery, even before it is delivered to or inspected by lessee or upon lessor's payment of the supplier for it, is a provision dictated by practical necessity. While most lessor's and lessee's would like to withhold payment of the supplier until the property has been delivered and accepted for all purposes of the lease, some suppliers, particularly those in another country, will refuse to ship the leased property until they are fully paid. Letters of credit and other traditional trade practices do not solve the problem. The reality is that lessor's have to pay before shipment in order for the lessee to receive the goods. Once the lessor has paid, it is fair that the lessee's obligations to the lessor become unconditional and irrevocable, even if this has happened before the property has arrived. Sometimes the lessee can inspect and accept the property at the supplier's business abroad. Yet, regardless, it must be remembered that is the lessee who has selected the property and supplier and who is bearing the equipment risk in the transaction.

This article contains a number of provisions from the comparable article in the IFC draft.

2. Lessee's Obligations Become Unconditional and Irrevocable Upon Acceptance

The lessee's obligations under a finance lease, including the obligation to pay rent, become unconditional and irrevocable upon the lessee's acceptance of the property.

Comment. From a lessor's perspective, the most important duty a lessee has is to pay the periodic lease payment. From a finance lessor's perspective, that duty cannot be

excused in any circumstance, including the occurrence of equipment problems or defects, casualties to the equipment, government seizure or any other reason whatsoever. Accordingly, most financial lease contracts throughout the world have a "hell or high water" provision that obligates the lessee to pay the periodic lease payment without excuse of any kind whatsoever.[4] These provisions are generally accepted as fair because the lessee chose the equipment and the supplier and the lessor would not have purchased the equipment but for the lessee's request. Similarly, a borrower would not be excused from repaying a bank loan just because it later decided that it did had a problem with the equipment it purchased with the loan proceeds. The IFC Draft has an equivalent provision.

3. Proper and Legal Use; Maintenance and Repairs

The lessee shall use the property in a reasonable manner in accord with its properties and purpose, and in compliance with all applicable laws, rules and regulations, operational manuals, and manufacturer's requirements. Lessee shall also at its own expense maintain and repair the property and keep it good, working condition unless the lease agreement provides otherwise. Without lessor's prior written consent, lessee shall not alter the property in any way nor replace any part with any inferior part; any alterations or repairs made with or without lessor's approval shall become part of the property and shall become subject to lessor's ownership right immediately upon having been made.

Comment. Since the lessee has possession and use of the property, it is only fair that the lessee be required to use it properly, prudently and legally, as well as to take good care of it, maintain it and not abuse it. This is always important, but it is critical once lessors start doing leases with residual-based pricing. If the properties are not returned in as good a condition as the lessor expected, including repairs made with inferior parts, the lessor will suffer a loss. This of course includes alterations that may have been made to the property. It is fair that the ownership right in approved changes vest immediately in the lessor in order to protect the integrity of the property and the completeness of its condition when it is returned. If special circumstances indicate a different treatment than provided by this provision, the lessor and lessee can so provide in the lease agreement. The IFC Draft has a comparable provision. (Note: The current Georgian Tax Code makes a distinction between repairs which can be deducted from income for Profit Tax during the current tax reporting period and those which are extensive enough that they must be capitalized and depreciated over time. The commercial law has no need for such a distinction and none is made here. This provision applies to all types of repairs, regardless of how extensive.)

4. Return of the Leased Property at Lease Expiry or Termination

At the expiration of the lease term or upon termination of the lease agreement, and in the absence of the proper exercise of any purchase option or renewal option given lessee by lessor, lessee shall return the leased property to lessor in as good a condition as originally delivered, except for normal wear and tear.

[4] The phrase "hell or high water" comes from traditional bare boat charter contracts which used language to make clear that the owner of the ship was not bearing the perils of the sea and that the charter party had to pay for its charter (lease) of the vessel "come hell or high water."

Comment. Since the lessee is only entitled to possession and use of the property during the lease term, once it is over, the lessee has an obligation to return the leased property.

5. Lessee to Bear Risk of Loss

The lessee shall bear all risk of loss respecting the leased property from the time of its delivery to the lessee until it is returned to the lessor.

Comment. Since the lessee has possession and use of the property, he is in the best position to look after it and keep it from loss, harm or damage. That responsibility starts once the lessee has received possession of it as that is the time from which he—to the exclusion of others—is in the best position to look after it. The IFC Draft would start such responsibility upon acceptance, leaving a significant gap.

6. Pledges, Liens and Encumbrances

The lessee shall not mortgage, pledge, encumber, lien or otherwise create a charge over the leased property.

Comment. Since the leased property is the property of the lessor, the lessee has no right to infringe upon or impair that right.

7. Duties, Fees and Taxes

Lessee shall be responsible for all import duties, registration fees, excise taxes, business turnover taxes and other similar assessments upon the leased property, unless the lease agreement provides otherwise.

Comment. Most finance lessees are "net" to the lessee, i.e., the lessee pays for all maintenance, insurance and taxes related to the property. Of course, the lessee is not responsible for the lessor's profit tax or income tax, just taxes specific to the property. Consistent with the customary practice, this law places that responsibility upon the lessee unless the lease agreement provides otherwise. Of course, the parties can provide otherwise in the lease agreement.

8. Location of the Leased Property

Lessee is obligated to keep lessor informed as to the current location of the leased property at all times and shall not move it to a new location without the lessor's prior written consent.

Comment. The lessor has to know where the leased property is in order to inspect it and, if necessary, repossess it. Also, some locations may put the property more at risk than others; this is especially true in Georgia. Lessees have also been known to intentionally hide leased property from lessors. The IFC Draft has an equivalent provision.

Article 11. Rights and Obligations of the Supplier

1. Obligations to the Lessee

The obligations of the supplier under the supply agreement shall also be owed to the lessee as if it were a party to the supply agreement and as if the leased property were to be supplied directly to the lessee. However, the supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

Comment. Ultimately, the supply agreement will be between the lessor and supplier directly, without the lessee being a party to it. This can happen because (1) the lessee, not already having entered into the supply agreement, asks the lessor to "please go buy this property and then lease it to me," or (2) the lessee has already entered into a purchase contract with the supplier, that the lessee will then just transfer to the lessor. In each of these cases, the lessee will not have or will no longer have a direct contractual relationship with the supplier and, therefore, will have a problem in making claims, such as for equipment defects, directly against the supplier. This provision solves that problem. Moreover, the supplier is protected from "double claims" on the same problem.

2. Lessor Changes to the Supply Agreement

The lessee's rights derived from the supply agreement shall not be affected by a variation of any term of the supply agreement previously approved by the lessee unless it consented to that variation.
Comments. In reality, the substance of the supply agreement is between the lessee and the supplier. It would be unfair to allow the lessor to change it without the lessee's approval.

Article 12. Rights and Obligations of Others

1. Lessor's Rights Valid Against Others

The lessor's real rights in the property, including but not limited to its ownership right, and other rights in the property shall be valid against the lessee's trustee in bankruptcy and creditors, including creditors who have obtained an attachment or execution. For the purposes of this paragraph "trustee in bankruptcy" includes a liquidator, administrator or other person appointed to administer the lessee's estate for the benefit of the general body of creditors.

2. Leased Property Not Part of Lessee's Bankruptcy Estate

The leased property shall not be considered a part of the lessee's bankruptcy estate.

Comment. Property leased pursuant to a financial lease should not be subject to the claims of lessee's other creditors. Because a financial lease serves a function similar to that of a loan, courts have sometimes failed to recognize the financial lease as a truly separate and distinct form of transaction with true ownership rights in the lessor. This has often been the case when the consequence of such a failure is to make the leased

property available to satisfy the claims of lessee's general creditors. This situation can be deterred if the leasing law is clear. The Convention is so explicit:

"The lessor's real rights in the equipment shall be valid against the lessee's trustee in bankruptcy and creditors, including creditors who have obtained an attachment or execution." Article 7.1.a.

This Article incorporates that provision, along with a clear statement that the leased properties are not a part of the lessee's bankruptcy estate. The IFC Draft has the equivalent provisions.

3. Return of Leased Property

Upon commencement of a bankruptcy proceeding covering lessee, lessee shall immediately return the leased property to lessor.

Comment. In most bankruptcy filings, the lessee will be going out of business. Immediate return of the lessor's property is obviously appropriate. If the lessee is attempting to reorganize its business and wants to continue to use the equipment, it will need to continue making the lease payments. Of course, the lessor and lessee are always free to negotiate a new arrangement within the rules of the country's bankruptcy law.

Article 13. Assignments and Other Transfers

1. Assignments and Other Transfers By Lessor

The lessor may assign, transfer or otherwise deal with all or any of its rights in the leased property or under the lease agreement without the consent of the lessee. Such a transfer shall not relieve the lessor of any of its obligations under the lease agreement or alter the nature of the lease agreement. The lease agreement may provide that lessee agrees not to property any offsets, counterclaims against any assignee or transferee of lessor.

2. Assignment and Other Transfers by Lessee

The lessee may not sublease, assign or transfer the right to the possession or use of the leased property or any other rights under the lease agreement or in the leased property without the prior written consent of the lessor and subject to the rights of third parties. Any such attempted sublease, assignment or transfer without lessor's prior written consent shall be null and void and conclusively deemed to have been in bad faith for all purposes under this and any other law.

Comment. This section comes from Article 14 of the Convention, which states the almost universal practice respecting assignments, subleases and other transfers of financial leases by lessors and lessees.

The difference in treatment between lessor and lessor is necessitated by the needs of the market. The lessor has to have the ability to pledge the lease and leased equipment in order to obtain funding to acquire it in the first place. Also, banks and other lessor

funding sources will not want to be subject to any offsets, counterclaims or defenses that a lessee may assert or have the right to assert against the lessor. It is only providing the funds for the lessor to acquire the property to be leased to a lessee. Accordingly, it is a standard industry practice, upheld by court cases, for the lease agreement to have the lessee waive such rights *as against the lessor's assignee*, e.g., the lessor's funding source. This is *not a waiver of lessee's rights against the lessor*; those rights still exist, and the article makes it explicit that such assignment does not relieve the lessor of its obligations under the lease.

The lessee's disposition of the lease needs to be restrained because the decision to acquire the equipment is one based upon the lessee's creditworthiness. A substituted lessee would mostly likely have a different credit profile and present a risk very different than the one the lessor bargained for.

Fraudulent and unauthorized subleasing, lessee sales of lessor's properties to third parties, secret transfers of possession and use of leased properties is a serious and major problem in many parts of the world, but especially within the CIS. Reportedly, it is sufficiently profitable to have attracted the interest of organized crime in some countries. This provision provides that such transfers are without any validity and that there can be no bona fide acquirer in such an event. The IFC Draft has equivalent provisions.

The IFC Draft also has an article on "Successor Rights" that would fit as item "3" above if it was to be included. Generally, the rights of successor, assigns, personal representatives, heirs and the like are adequately and properly covered by other laws. There is no need for a special provision in the leasing law. Moreover, the lease agreement will typically have a "successors" provision appropriate for any special issues arising in connection with that lease, leases of that type, or leases to that particular market sector.

PART IV

CONCLUDING ARTICLES

Article 14. Captions

The captions used in this law are for purposes of quick reference only are not to be used for interpretation or limitation of the articles contained below them.

Article 15. Severability

If any article or any part of any article shall be found to be in violation of the Constitution or superior law of Georgia, it and it alone shall be severed from this law and all remaining articles and parts thereof shall remain in full force and effect.

Article 16. Effective Date

This law shall be effective from the date of its promulgation.

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Civil Code Amendment re Repossession Procedure

Please note: The following suggested substance for amendments of the Civil Procedure cover an extremely important and critical matter: expedient repossession by lessor in Code the case of lessee default. These provisions do properly belong in the Civil Procedure Code, which may or may not be easier to amend than the Civil Code. If amendment of the Civil Procedure Code cannot be properly and timely effected by this enactment of this Proposed Law as a special law, then the substance of these provisions should be included in this Proposed Law. There may also be a new draft Civil Procedure Code under consideration, to which this author does not have current access. The following substantially incorporates the IFC recommendation on court ordered repossession procedure.

Upon a lessor request for a court order directing the lessee to immediately return the leased property to the lessor, the court shall issue such order within three (3) days upon presentation of an affidavit by lessor with a true copy of the lease agreement attached and a statement in the affidavit that the lessee is in default of the lease agreement and the basis of the default. The order shall issue upon no further proof. Such order shall not be suspended or appealed, but lessor shall remain liable for any damages caused to lessee by such order shall it subsequently be proven that repossession was a breach of the lease agreement by lessor under the circumstances.

Comment. The substance of this provision is critical. Repossession is a key right of a lessor, and all too often it cannot be effectively exercised because of court delays and outdated civil procedures. Please see the Report that accompanies this Proposed Law for a much more detailed elaboration of the need for practical, expedient repossession.

[appropriate concluding language for legislation enacted by the Georgian Parliament]

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APPENDIX: B

THE SIX PHASES OF THE LEASING CYCLE

by S.C. Gilyeart

JD with Honors (Law), BA with Honors (Economics)
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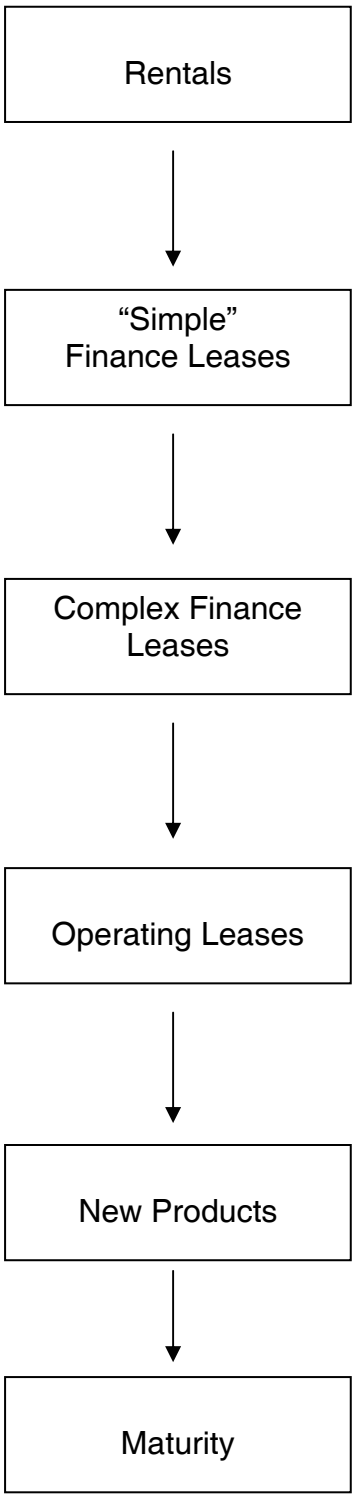
Stages in the Evolution of Leasing Markets

Leasing's evolution in some ways is no different than that of any other industry in the world in that leasing progresses from being newly born to becoming fully developed. Leasing is, of course, nonexistent in many of the extremely underdeveloped and/or politically ravaged economies such as Afghanistan, Ethiopia, Sudan, and elsewhere in the developing world. It has recently come into existence in countries such as Egypt. In countries in the Asian Pacific region, Latin America, Central and Eastern Europe, the Baltics, and Africa, leasing has become established and is evolving in sophistication. Leasing has matured[1] in countries such as the U.K. and the U.S. It may also be considered mature in some countries of the European Union, particularly Western Europe, although lease product offerings in such markets may be somewhat limited (e.g., France).

How the industry moves from one stage to another and what causes such movement is best understood by reviewing the six phases of the leasing cycle.[2]

(Please go to the diagram on the next page)

[1] Maturity will not be automatically followed by decline. Continued lessor creativity leading to new products will cause leasing to continue to grow through the maturity stage.
[2] As postulated by Sudhir Amembal of *Amembal & Gilyeart, Counselors to Government*


Rentals
"Simple" Finance Leases
Complex Finance Leases
Operating Leases
New Products
Maturity

The Six Phases of the Leasing Cycle

Rentals (Phase One) have preceded the leasing product by centuries and even today, this industry is extremely vibrant and competitive in almost every country in the world. Rentals are characterized by their short-term (usually less than 12 months)[3], full-service nature. At the end of the rental contract period, the user returns the equipment to the owner.

Modern day leasing began over a century ago — both in the U.K. and the U.S. — in the form of the "Simple" Finance Lease[4] (Phase Two). In every single country in the world this is the first lease product as distinguished from the rental. The product is characterized by the lessee's intent to eventually own the equipment. The lease is merely a financing instrument. At the end of the lease term, the lessee, having fully paid the lessor through the lease rentals,[5] title is transferred to the lessee for no additional consideration or the lessee purchases the equipment for a nominal amount.

As leasing is a new product, the psychology of ownership is still very much inherent in the user's thought process. The lessor too intends to merely finance the equipment through a lease and is not willing to have the asset returned at the end of the term. Credit risk, not asset risk, is acceptable to the lessor, as the latter requires a developed secondary market, which does not necessarily exist during this phase. The lease product is almost invariably offered on a net basis in which the lessor's services are limited to financing the equipment.
During this phase the market is usually rate driven and not driven by value added. However, even lessors with rates that are not necessarily market competitive are able to survive as the lessors with better rates have a capacity problem. Countries in this phase include Bangladesh, Croatia, Nicaragua, Romania and Georgia.

Both with the passage of time and the entry of other players in the market, the leasing industry enters Phase Three - the "Complex"[5] Finance Lease Phase. During this phase, lessors begin to structure[6] many of their finance leases and also provide the lessee with varied end of term options such as the option to renew based on a fixed residual. (The lessee must either purchase or renew.) It is during this phase, in most countries, that leasing experiences the largest growth, in terms of both absolute volume and market penetration. Also, many dealers/manufacturers that previously have relied on independent leasing companies begin to form their own leasing companies. Tax authorities and regulators, realizing the significance of leasing, take a closer look at the industry and establish rules, regulations, and guidelines, meant to stimulate further growth.

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[3] While a dictionary would consider "rental" and "lease" to be synonyms, modern usage of the words "rental" and "leasing" have developed such that "rental" connotes a lease of less than 12 months, while the word "lease" connotes a rental of 12 months or more. It must also be noted that in countries influenced by the legal codes of the Former Soviet Union, there are several different words for leasing, with each having a treatment in the Civil Code. Needless to say, this can create confusion. The better approach is to leave this historical distinction behind and instead distinguish between only (1) rentals (less than 12 months) and (2) "leases" (12 months or more), which could be either (a) operating or (b) financial leases.

[4] The words "Simple" and "Complex" are words used to distinguish between the two types of finance leases in the context of the evolution of leasing. In the marketplace, both these types of leases are known as "finance leases."

[5] These are known as full-payout leases in which the lessor is fully paid out from the rentals with no reliance on any residual value at the end of the lease for the lessor's financial return in that particular transaction.

[6] For example, leases may structured to suit the cash flow needs of the lessees, with lease payments no longer level but different at different points in time.

This phase is generally rate-focused, though some lessors, pressured by competition, begin to address the value added aspects of leasing. These aspects may include shortening the response time from the date of lease application to the date of lease funding or bundling of services, such as maintenance, into the finance lease. As the market experiences substantial growth, rate-focused leasing at times leads to volume competition. Lessors begin to narrow their spreads in a buyer's market. Continued narrowing of spreads causes many lessors to exit the industry, as evidenced in India about 15 years ago and as recently experienced by the Korean leasing industry. The industry learns from experience that it cannot remain rate driven. Examples of countries in Phase Three are El Salvador, India, Pakistan, Panama, and Peru.

Phase Four, the Operating Lease Phase, comes about with the passage of time, intense competition, transfer of technology from one leasing country to another, demand by multinational lessees, and developing or developed secondary markets. In some countries, such as Mexico, the product is fueled by the fact that finance leases are denied "true lease" or "tax lease" status. In many countries the introduction of accounting rules, moving the country from *form* to *substance*, fuels the demand for operating leases. In *substance* countries, only operating leases offer off balance sheet financing to the lessee.

The key features of this product are the ability of the lessee to return the equipment at the end of the lease term, and the full-service nature of many operating leases. Bundling and one-stop-shopping become a convenience to the lessee. With these features, (using computers as an example) hardware, software, installation, maintenance, and training are packaged into one transaction.

During this phase, unconnected to the operating lease product, the lessee becomes an astute, sophisticated player as leasing has become more and more acceptable as an extremely viable financial product. As a result, language in lease contracts is not unilaterally drafted by the lessor, but is carefully negotiated; in fact, quite often, lessees insist on using master leases drafted by their own legal counsel.

Countries Engaged in Operating Leases

Argentina*	France	New Zealand
Australia	Germany	Nigeria
Belgium	Ghana*	Norway
Brazil	Indonesia	Poland
Chile*	Ireland	Romania
Colombia	Israel	Slovak Republic*
Costa Rica	Italy	Sri Lanka
Czech Republic*	Japan	Taiwan
Denmark	Mexico	Thailand**
El Salvador	Morocco*	United Kingdom
Estonia	Netherlands	United States
Finland		

*Minimal **Mainly automobiles

Source: Global Survey, Amembal & Associates, 1999

On-going intense competition, continued lessor creativity, and ever-increasing transfer of technology propels the industry into Phase Five, the New Products Phase. In this phase, the operating lease becomes quite sophisticated, with complex end-of-term options (such as puts, calls, and other flexible option and amendment provisions), early termination options, upgrades and rollovers, technology updates, and other innovations that allow the parties increased flexibility to adjust the terms of their lease to changing financial and technological changes. Phase Five brings about new products such as securitization, venture leases, and synthetic leases (a lease which is a loan for tax purposes and a lease for financial accounting purposes). Countries in this phase include Australia.

Finally, the industry, following the classic industry curve from infancy to maturity, enters the last phase, Phase Six, Maturity. Maturity is characterized by substantial consolidation within the industry. Such consolidation takes the form of mergers, acquisitions, joint ventures/alliances, and equity roll-ups (the latter recently witnessed in the US). Maturity also brings forth lower margins, causing lessors to look for profits through operational efficiencies as versus increased sales volume. Lessors focus more upon asset issues rather than credit issues and become more expert regarding specific types of equipment. Lessors become stronger equipment specialists to add to their financial expertise and to differentiate themselves from a crowded and competitive field. Overall leasing penetration also flattens during this phase, and leasing volume increases only with the overall growth of the economy. Additionally, fewer truly innovative lease products are introduced. Countries with mature leasing markets are the U.K. and the U.S.

Though the six phases apply universally, it is important to note two points. First, the sequence applies to the industry in general within each country, and not to all of the players. It is very common for lessors not to grow sequentially. Some that offer new products such as venture leases may not be in the operating lease business. Second, each phase is not mutually exclusive. Using the US as an example, though the industry has reached maturity, many lessors continue to offer only finance leases, others specialize in operating leases, and others diversify into products such as synthetic leases. However, there is a risk if the leasing economy gets "stuck" at the simple finance lease stage, as happened in Korea. Although Korea went quickly from having no financial leasing in 1978 to having one of the tenth largest leasing economies in the world, it never expanded beyond the "simple" finance lease stage. When the Asian financial crisis hit in 1997, the financial leasing industry was decimated, dramatically illustrating the need to create an environment to allow and encourage the leasing marketplace to grow through the leasing cycle and diversify its sophistication with a variety of products.[7]

As emerging markets evolve toward maturity, it is critical to note that the leasing cycle (from the simple finance lease to maturity) has become shorter and shorter. This is due to information sharing and technology transfer among markets, speeding progress through the evolutionary cycle.

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[7] Of course, there were other problems too, such as lessors repeatedly doing transactions with negative "profits" in pursuit of greater market share. Yet, this approach arose in part because of a reluctance to innovate.

APPENDIX: C

"LEASES AND RENTALS" AND "FINANCE LEASES AND OPERATING LEASES"

by S.C. Gilyeart

JD with Honors (Law), BA with Honors (Economics)
Admitted before the US Tax Court

There is much confusion in the world today about "leases and rentals" and "finance leases and operating leases" and the differences between them all.

To put rental, operating leases, finance leases and loans in perspective, consider the following:

(Please read from top layer to bottom, with each lower layer representing a subset of that which is above. For example, the goal is "acquisition." Of what? Use Only or Use & Ownership?)

When a person has need of an item of property (an "asset"), it does not mean that the person has to buy it. They might just need to use it for a while. Still, the most fundamental level of decision making its to "acquire it", whether that means acquiring the use of it or acquiring the ownership of it, or both.

Consider the process:

If you are considering acquiring something, you go through a series of "layers" of decisions until you ultimately end up with a particular type of transaction that meets your needs.

First Layer of Decisions:

Acquisition (Yes or No)

Second Layer of Decisions:

The next decision is: do I need to own it or is just the right to use it enough?

Acquisition (Yes)	
Of Use Only ?	*Of Use & Ownership?*

Third Layer of Decisions ("Use It Only" Decision):

Assuming that I only need to use it and not own it, the next question is: how long do I need to use it? If it is for a period of lease than a year, then I would "rent" it. If it is for longer, I would "lease" it. Such a lease would be considered a "true lease."

Acquisition		
Of Use Only		*Of Use & Ownership*
Rental (< 1 year)	"True Lease"	Purchase or Installment Sale or "Lease=Purchase"

Third Layer of Decisions ("Use It & Own It" Decision)):

Of course, I could decide that I not only want to "use it" but I want to "own it" as well. Then a rental or true lease would not work. I would either purchase it for cash or on a loan (and title is transferred to me immediately) or I might purchase it on an installment sale basis[1] or even do a lease that ultimately results in a purchase (because title will be transferred to me at the end, after I have made all my payments.)

Acquisition		
Of Use Only		*Of Use & Ownership*
Rental (< 1 year)	"True Lease"	Purchase or Installment Sale or "Lease=Purchase"

Where do the terms "finance lease" and "operating lease" come in?

Please note that the terms "finance lease" and "operating lease" have not been introduced, yet. If introduced, ***the term "finance lease" would cover everything but the rental of less than a year***:

Acquisition		
Of Use Only		*Of Use & Ownership*
	"Finance Lease"	
Rental (< 1 year)	***"True Lease"***	***"Lease=Purchase"***

The term "operating lease" is unnecessary for commercial law purposes; however, if it was used, it would cover both the rental transaction and the true lease; it would not encompass a lease that is just a type of purchase mechanism:

Acquisition		
Of Use Only		*Of Use & Ownership*
"Operating Lease"		
Rental (< 1 year)	***"True Lease"***	Purchase or Installment Sale or "Lease=Purchase"

Thus, combining the two, you can see that ***there is an overlap between "finance lease" and "operating lease"*** from a transaction perspective**.** (This would not be the case in accounting, where the terms are mutually exclusive.):

[1] also called a conditional sale or credit sale

Acquisition		
Of Use Only		*Of Use & Ownership*
	"Finance Lease"	
"Operating Lease"		
Rental (< 1 year)	***"True Lease"***	Purchase or Installment Sale or "Lease=Purchase"

Thus, *on an economic transaction basis*:

1. all "operating leases" will be "true leases", while
2. *some "finance leases" will be "true leases" and some effectively will be purchases instead.*

Yet, while accounting needs to sort these out, as do tax regimes which follow an economic substance rather than a form approach, commercial law does not.[2] *How quickly a lessor recovers its cost investment in an asset says nothing about the appropriate rights and remedies scheme between it and its customer.*

It must all be remembered that the key innovation of modern leasing is that lessees began selecting the equipment and supplier that the lessor then acquired the equipment from specifically for lease to them—rather than having lessees just select from an inventory that lessors already had. Without that, an installment sale, a transaction form that has been around a lot longer than financial leasing, would have sufficed. Lessors would never have gotten involved.

[2] Please see *The Leasing Infrastructure Matrix* in the appendices.

APPENDIX: D

THE LEASING INFRASTRUCTURE MATRIX

by S.C. Gilyeart

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Admitted before the US Tax Court

Like any business, leasing is impacted by the laws and other rules that constrain or promote its business practices. There are four major areas that establish the operational infrastructure for the leasing industry:

1. *Legal* (meaning commercial law, e.g., contracts and their enforcement);
2. *Tax* (both direct and indirect);
3. *Accounting* (financial accounting); and
4. *Regulatory* (licensing and supervision, if any).

Each of these areas has a different goal and purpose to their rules because they face different issues and concerns. This may be best illustrated by the following matrix:

"The Leasing Infrastructure Matrix"		
Area	***Purpose/Goals***	***Issues***
Business	*Make a Profit*	*Competition and Service*
Legal	*Resolve Private Disputes*	*Rights, Remedies, Enforcement*
Tax • Direct • Indirect	*Raise Revenue & Direct Social Policy*	*Fair Burden Sharing, Tax Incentives and Disincentives, Administration Efficiency*
Accounting	*Accurately Reflect Financial Conditions*	*Balance Sheet/Income Statement Treatments*
Licensing/Supervision	*Maintain Public Confidence in Financial Sector*	*Appropriate Licensing Requirements and Prudential Norms*

Since each of these areas has such a different focus from the others, it is not surprising that each has its own set of rules and regulations. And as definitions are the starting point for any rule or regulations, as they establish the scope of the application of that

set of rules, it follows that the definitions may be different. This is especially true when it comes to the definition of "finance lease" (or "financial lease"—the terms will be used interchangeably in this paper).[1] Thus, the definition of finance lease may not be the same for tax as it is for accounting, and the definition for legal (commercial law) purposes may be entirely different yet. *And this "different rules for different purposes" is desirable*!

"Different rules for different purposes" cannot be emphasized enough! Crafting the definition or rule for the specific purpose at hand allows for a better handling of the issues and a greater likelihood that the desired goals will be achieved. Without the sophistication of using a *"different rules for a different purpose"* approach, the development of leasing to its full potential within the country will be significantly impaired. In fact, the critical usefulness of that rule-making approach has been largely responsible for leasing achieving the phenomenal success it has as a uniquely valuable financial and capital-formation technique.

Form versus Substance

One of the most useful aspects of modern leasing is that a transaction in the *form of a lease* ("form") can be used to accomplish something with an entirely *different economic substance* ("substance"). For example, a *simple finance lease* can be used to create the economic substance of an installment sale or secured loan, but with a lease rights and remedies scheme. An *operating lease* can be used to allow a business to gain use of a needed production asset without having to take an immediate charge to its balance sheet. A *synthetic lease* can be used to create a loan for tax purposes (lessee gets the asset depreciation) but a lease for financial accounting purposes (showing an expense, not an asset). The most clever use of leasing to date was in the United States in 1981 when the newly-elected President Ronald Reagan's administration used the lease format to jump start a very ailing US economy by allowing companies with unused tax benefits to "sell" them to companies that could use them; leases were considered the most elegant means of accomplishing this goal, requiring minimal changes to the tax code. After having the intended economic revival effect, these *"tax benefit transfer leases"* were prohibited a year later.

This flexibility comes about in part by focusing upon the form of the transaction for one purpose and the economic substance of the transaction for another. And that shift in focus is justified by the different considerations in the different areas of the leasing infrastructure. Adding the form v. substance dimension to *The Leasing Infrastructure Matrix*, it becomes:

(Please go to table on the next page)

[1] The same is true for "operating lease" or "operational lease."

The Leasing Infrastructure Matrix			
Area	***Purpose/Goals***	***Issues***	***Form v. Substance***
Business	*Make a Profit*	*Competition and Service*	*Substance*
Legal	*Resolve Private Disputes*	*Rights, Remedies, Enforcement*	*Form or Substance*
Tax • Direct • Indirect	*Raise Revenue & Direct Social Policy*	*Fair Burden Sharing, Tax Incentives and Disincentives, Administration Efficiency*	*Form or Substance*
Accounting	*Accurately Reflect Financial Conditions*	*Balance Sheet/Income Statement Treatments*	*Substance*
Licensing/ Supervision	*Maintain Public Confidence in Financial Sector*	*Appropriate Licensing Requirements and Prudential Norms*	*Form or Substance*

Clearly, for accounting to "accurately reflect the financial conditions" of a business, the rules must conform to the economic substance of the business activities. In emerging economies where leasing is new or nonexistent, using the form approach for direct taxation is often advisable; when the economy and the leasing industry have become more developed, a switch to substance can be made, if desired. In the legal environment, the most appropriate allocation of rights and remedies is often best achieved by the form approach.

As with rule-making with *"different-definitions for different purposes"*, proper use of the "form v. substance" approach is a critical tool for creating a healthy environment for modern leasing to develop and contribute to a country's economy.

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APPENDIX: E

DRAFTING A MODERN FINANCIAL LEASING LAW

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In recent decades financial leasing laws have been enacted around the world in countries with a wide diversity of economic maturity, from the developing and transitioning to the mature. However, most of these leasing laws are poorly drafted. Many hurt the country's leasing industry rather than help it. The reasons for this are varied, but most come from a minimal understanding of what leasing is, what it can be and will become, and how it can make its maximal contribution to the country's economy. Many leasing laws are an excellent illustration of the maxim *"a little knowledge can be a dangerous thing."*

Some have talked about a "model leasing law". Although there are fundamental drafting principles, essential and unacceptable provisions, and a proper boundary for the leasing law's application and coverage, the details can and should vary from country to country. Legal traditions differ, economic development situations differ, business practices differ and the stage of leasing's development in the country differs. Yet, while accommodation and adjustment for local circumstance should be made, there are universal "fundamentals" that must not be ignored.

General Guidelines for Quality Legislative Draftsmanship

A good commercial law, as will many other types of legislation, adheres to five basic guiding principles:

1. *Simplicity*
2. *Compatibility*
3. *Effectiveness*
4. *Practicality*
5. *Longevity*

1. *Simplicity*. The law should be simple and straightforward. A law that is hard to understand is difficult to follow and is honored more in breach than in observance. While a law that strives for simplicity may trade off coverage of some more complex and sophisticated situations, a clearer and more disciplined set of principles is obtained for the vast majority of circumstances. A commercial law best serves its society when it serves the regular and normal circumstances rather than the obscure and rare.

2. *Compatibility*. To the extent appropriate, a new should be drafted with a view to existing law and practices .Proposals for change in such law and practices are not meant to imply in any way that existing approaches are "wrong"; rather, such proposals are made with a desire to improve and further economic development of the economy

through increased availability, flexibility, and suitability of new commercial mechanisms.

3. *Effectiveness*. The law has to work if it is going to be effective. While simplicity and practicality enhance effectiveness, effectiveness as a guiding principle means that parties engaging in commercial transactions will have greater confidence as to the legal treatment and consequences of their contracts as a result of the law. While not every possible commercial structure can be encompassed by any law (especially one which espouses simplicity as one of its guiding principles), an effective commercial law will enhance the predictability of transaction treatments and will provide a stronger base for hypothesizing the treatment of the unique.

4. *Practicality*. The law must be practical. Whenever possible, it ought to accommodate existing business practices and understanding. Generally, the law ought to reflect business reality rather than to artificially direct it. In other words, the law should not attempt to reinvent an industry from a brand new mold.

5. Longevity. The law should have a reasonable life such that it does not have to be repeatedly rewritten in short order. That is not to say that regular and periodic revisions will not be needed; rather it is hoped that the basic structure and concepts of the law will serve useful for some time to come.

Three Fundamental Leasing Law Principles

The basic structure of a modern financially-oriented lease is quite different from that of a traditional rental, and it needs legal provisions that are often just the opposite of what is appropriate in a rental. For example, under a traditional rental, a lessor would be responsible for equipment defects; under a finance lease, the lessor would not, as the lessee would have chosen the equipment and the supplier and will usually know much more about the equipment than the lessor. The supplier is a critical third party in a modern finance lease. This fact needs to be recognized and the duties assigned by the law need to be consistent with each party's role in the transaction.

Moreover, the law should be just a fall-back framework for parties who fail to cover a topic in their lease agreement or when the provision that they have just does not work in the particular circumstances that occurred. It should not mandate provisions that cannot be changed by contract, and if it does, it should be very explicit that those provisions cannot be changed by the parties' agreement. Freedom of contract must be paramount if leasing is to be able to contribute its hallmark characteristic—its flexibility.

Thus, a good financial leasing law follows three fundamental principles:

1. *A definition of finance lease that is based on recognition of the three-party structure of modern financial leasing and not one based on accounting or tax classification rules;*
2. *Duties consistent with each party's role in the transaction*
3. *Freedom of contract in negotiating the parties' agreements*

Every provision in a quality leasing law should be tested against these three principles--and included only if it passes the test.

Essential, Acceptable and Unacceptable Provisions

A quality leasing law must have certain provisions. There are others it must not have. Then there are some that may be appropriately included under the country's particular circumstances.

Essential Provisions

These are the essential provisions:

1. *the proper definition of finance lease;*
2. *only an absolute minimum of mandated lease agreement terms (e.g., property description, start date and payment amounts, periods and terms);*
3. *lessor's ownership right;*
4. *lessor's warranty of quiet use and possession;*
5. *lessor's lack of liability to third parties;*
6. *lessee's absolute duty to pay lease payments after acceptance;*
7. *lessee's bearing of the risk of loss;*
8. *lessor's lack of equipment responsibilities;*
9. *lessee's recourse against the supplier for equipment defects and problems;*
10. *assignability freedom for lessor and restraint for lessee;*
11. *lessor's ability to expediently repossess upon a lessee default;*
12. *lessor's ability to accelerate the remaining lease payment upon a lessee default; and*
13. *lessee's duty to return the leased property at expiry or termination; and*
14. *exclusion of the leased property from the lessee bankruptcy estate and its expedient return.*

These provisions are essential in the law because they are essential in industry practice. A financial leasing law which strives to rewrite the basic core business practices that distinguish leasing can do serious harm to everyone--lessors, lessees and the country's economic potential. As stated above, a good commercial law will reflect business reality rather than artificially direct it ("*practicality principle*").

Acceptable Provisions

Because of current marketplace problems, existing legal confusion, or a country's commercial law traditions, more than just the essential provisions may be recommended. Properly conceived and drafted, provisions covering some of the following topics can also be included in a quality leasing law:

1. *security deposits;*
2. *labels;*
3. *indemnification;*
4. *insurance;*
5. *maintenance and repairs;*
6. *duties, fees and taxes;*

7. *property locations; and*
8. *pledges, liens and encumbrances*

Of course, there could be other acceptable provisions that are needed to deal with special situations found in the country, such as currency controls, barter economics, special notary rules, banking controls and the like.

Unacceptable Provisions

These are the most unacceptable of unacceptable provisions:

1. *A definition of finance lease based upon anything but the following two criteria:*
   (1) lessee's selection of the equipment and the supplier and
   (2) lessor's acquisition of the equipment specifically for lease to the lessee.
2. *A mandatory requirement that the leased property be transferred to the lessee at the end of the lease;*
3. *A mandatory requirement that the lessee have a purchase option (or renewal option); and*
4. *Any provision that is contrary to the Essential Provisions.*

Inclusion of these Unacceptable Provisions will arbitrarily and artificially constrict the ability of the leasing industry to grow and develop and introduce new and needed lease products; they would cripple the main attribute that leasing confers to the country's economic development—*leasing's flexibility*.

The Details

It is not the scope of this paper to present a detailed elaboration of a written leasing law. As stated, each country's law will be different. Still, there has been so much confusion and so many legislative errors, it is hoped that this paper will encourage more informed drafting in the future.

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APPENDIX: F

REPOSSESSION AND LEASING TRANSACTIONS

by S.C. Gilyeart

JD with Honors (Law), BA with Honors (Economics)
Admitted before the US Tax Court

The ability to repossess the leased equipment from a non-paying lessee is of critical importance to a lessor. This ability can be on a self-help basis or involve the assistance of the courts.

Self-Help Repossession

The phrase "self-help repossession" is a reference to the action of the lessor in simply going to the lessee and taking away the leased equipment, with or without the lessee's consent, upon a lessee default under the lease contract. The lessor usually bases the right to such action upon a provision in the lease contract that expressly gives the lessor the right to do so. Whether local law supports such a contract provision, prohibits it or is silent about it, is a different issue. Without one or the other of a contractual basis or a provision in the civil or commercial code or other applicable law, a lessor may be ill advised to take such action. Of course, the most basic justification is that as the owner of the assets leased by the lessee, it is the lessor's own property that it is recovering. And this may be enough under some legal systems, especially those that are somewhat "rudimentary" or in the early stage of their transition from a formerly different political/economic/legal environment. Such countries do not have a very substantial body of law yet developed, particularly as regards the relatively sophisticated implications of financial lease transactions. Yet, in more developed legal environments the law will have something to say about the issue.

Legally-Empowered Self-Help Repossession

In some countries the law specifically provides an endorsement of a lessor's ability to proceed with self-help repossession efforts upon a lessee breach of the lease agreement, so long as such effort will not create a "breach of the peace." This means that the lessor must "back off" and resort to the courts if the lessee presents an active resistance such that a fight, a forced entry, a trespass that could result in violence or even a threat of violence, might occur. "Breaking and entering" or other conduct that would normally be a crime is not allowed, even if the contract would seem to give the lessee's consent to it. Yet, a contractual provision allowing for repossession upon default may not be required if the law itself provides for self-help repossession. The Uniform Commercial Code of the United States provides just that for not only leases but for traditional loans with collateral and conditional/installment sales as well. Nevertheless, it is always far better to have such authorization clearly set out in the agreement between the parties themselves, i.e., in the lease agreement, than to rely solely upon the statute.

Non-legally Empowered Self-Help Repossession

In most civil law countries, self-help repossession is not provided for in the law. That does not necessarily mean that it is prohibited but rather that the law does not provide an authorization for it. In such a country a lessor with a self-help repossession clause in its lease agreement may have sufficient legal authority to take action. However, the usual situation is less clear. Depending upon the language of other provisions in the civil or commercial code, the provisions of the statutes may work together in such a way as to in effect bar self-help repossession. For example, the protections afforded one with a possessory right may create a claim for damages for interference with that possessory right such that repossession is not viable, even by one with an ownership right. Other times, a restraint on self-help repossession may be deduced from the overall tenor of the code and the perception that a self-exercised remedy would be severely frowned upon by any judge ultimately involved in the matter.
Yet, in many countries, especially those with a less developed judicial system, and particularly those where the courts are not effectively functioning, lessors are inclined to help themselves, sometimes with the assistance of "strongmen." These lessors rely upon their contract language and their ownership position in justification of their action if such matter should ever end up in court. In such circumstances, lessors are inclined toward aggressive action because the reality is "either the repossession remedy or no remedy."

"But I don't want it back!"--The Problem of Inadequate Secondary Markets

Even if the lessor does recover possession of its leased asset, it may not be enough. There may be no secondary market for the asset and no ability to sell it for any sum that would come close to "making the lessor whole." This is usually a significant problem in emerging lease markets, enough so that many lessors do not want the equipment back, even in a default situation, and have complained bitterly about judges who have ordered the equipment's return. Of course, the complaint is really about the "credit" that is given the lessee on its total lease bill for the "value" of the leased equipment. Even though there is no secondary market, judges in such circumstances have been known to give equipment an arbitrary and artificially high value, often wiping out the lessor's claim for any further monies from the lessee. This has been one of the problems for lessors in China.

The functional usefulness of repossession as a real tool for a lessor faced with a lessee default in an emerging lease market where there is no realistic secondary market for used equipment of the type leased is a problem that goes beyond the ability of legal contracts to solve. This does not mean that lessors should omit repossession provisions from their contracts but rather that they must be realistic about what they will do for them. It may not make them money. Sometimes it may do nothing more than allow them the ability to deprive the lessee from use of an asset for which they are not paying.

Yet, that alone may have significant value and may be a strong factor in encouraging the lessee to make those periodic lease payments. In fact, in economies without an adequate secondary market, that is the main value of a repossession capability--and that value should not be underestimated.

Moreover, the secondary market will ultimately develop, even if the development occurs in fits and starts. Vehicles usually lead the way, along with or followed by heavy equipment; office equipment tends to bring up the rear. Leasing needs strong secondary markets. Once leasing gets past the stage of being nothing more than a "disguised loan or installment sale" and the leased assets are being returned to the lessors, leasing begins to "manufacture" used equipment as part of its production process. This used equipment is not a "by-product" but an integral part of the leasing business. And strong returns on this product will allow for lower lease payments to the lessee, which translates at the macro-economic level to a lower cost of capital for business.

Judicially-Assisted Repossession--Post-Judgment

Most judicial systems have a mechanism for compelling the return of assets to their rightful owner, at least after a judicial conclusion of the case. This is true for common law and civil law systems alike. Modern socialist systems may or may not have yet enacted laws that make the process easy, although the civil and commercial codes are structured and written in a way that accommodates such judicial assistance in principle. However, the reality is that the delays of the judicial process are often so great that if the equipment is indeed ultimately returned after the pronouncement of a judgment and the effort taken to enforce it, the equipment has so declined in value that the recovery is economically meaningless. Additionally, the present value of the funds realized upon such delayed disposition of the asset makes the effective recovery even worse. This situation is aggravated even further by the common circumstance that countries with marginally functioning judicial systems with lengthy inherent delays often have significant levels of inflation, making for an exacerbated decline in that present value.

Judicially-Assisted Repossession—Pre-Judgment

Fewer legal systems have a process for pre-judgment return of assets to a claimant making a challenge against the one currently in possession. Common law systems are better in this regard than are many civil law systems. The existence of such a pre-judgment, "summary procedure" can provide a big boost to the development of the leasing industry within a country, as it makes judicially-assisted repossession a practical and effective tool. Even in countries with a strong self-help heritage, the value of a judicially supported repossession process has been proven. In fact, the existence of the judicial resort usually encourages cooperation by defaulting lessees and can promote uncontested repossessions. Breaches of the peace are avoided, lessors get an early recovery of the asset that they own, the courts may not have to be involved, and a lessee who feels that the repossession was wrongful under the circumstances can still make a claim for compensation against the lessor.

In civil law systems that do support pre-judgment property recovery, the presumptive validity of the lessor's claim of entitlement is often supported by the fact that the lease contract has been notarized. Notary systems are a hallmark of the civil law tradition and provide a verification function for a variety of "public acts." In some civil law countries, a contract must be notarized to be valid and enforceable. Even if notarization is not such a requirement, it can still be a good idea to have the lease contract notarized. Notarization creates a strong presumption of contract validity, sometimes a conclusive

one. These notarization structures can provide a foundation supportive of judicially-empowered repossession. In other words, if the lease contract is notarized, a lessor should be entitled to a court order on short notice that authorizes its repossession and directs assistance from local law enforcement authorities if necessary.
Pre-judgment, judicially-assisted repossession can also be supported in some countries that have lease registries. If the lease is registered, the lessor should be entitled to a summary repossession procedure. While relatively few countries have lease registries, more are considering them. Of course, it does not follow that the repossession right be conditioned upon registration. Rather, the registry, as in the case of notarization, can be used to provide a "boost" to a process that may not have been traditionally recognized by the existing judicial system.

Without a doubt, the most effective registry is the Uniform Commercial Code filing system in the United States. While being directed toward "secured transactions," i.e., loans with collateral and conditional/installment sales, it accommodates registration of leases as well. Although registration is not a prerequisite to judicially-assisted repossession in the United States, the legal environment for leasing has developed differently there than in emerging markets and repossession activities are effective without such support. Yet, regardless of how it comes to pass, effective repossession processes, both judicial and extra-judicial, are necessary for the healthy development of a domestic leasing industry.

The Trend in Repossession Activity

It may be ambitious to talk about a "trend" in repossession activity; if there is one, it is modest and barely discernible--but it may be there. While that trend is toward a more "repossession friendly" environment, it is for different reasons in different markets.

Leasing has become well recognized by the World Bank, the Asian Development Bank, US AID and other multilateral and bilateral development agencies as a useful and practical tool for accelerating development of capital markets in emerging and transitioning economies. It is a critically important financial tool in the small and medium sized enterprise (SME) sectors of these economies, and it is usually from the SMEs that growth in the national economy occurs. An SME that cannot qualify for a bank loan, may be able to obtain a lease, because "ownership of the asset gives the lessor strong security. ...leasing offers the advantage of ... simpler repossession procedures, because ownership of the asset is already in the lessor."[1] Yet, to make that incentive effective, the repossession laws must really work. As a result, when financial leasing laws are proposed for these countries, attention to deficiencies in repossession processes is an important element of the proposal.

In mature markets, almost by definition, the courts are functioning adequately and the business community has reasonable expectations surrounding return of equipment that is not being paid for. While there will always be the infuriating lessee who just refuses to cooperate not only with the lessor but even with the courts, the problem is not systemic to the industry as a whole. This orientation toward cooperative return of the equipment is also being supported by the trend in shorter lease terms, with a focus on upgrades, rollovers, substitutions, and other more "service"-oriented product elements.

[1] *Leasing in Emerging Markets*, IFC, 1996), p. 3.

Unlike the lessees in an emerging market who have the mind-set that they are "buying it" and that the leased equipment "is theirs," lessees in more mature markets want to have less and less to do with the equipment and want lessors to provide more and more services in the care, management, and replacement of it.

The capability to repossess the leased assets when the lease is in default is an important risk mitigation tool for not only an individual lessor but for the development of the leasing industry itself. On a worldwide basis, the legal and judicial support for repossession activities lacks much to be desired. Yet, it is ever so slowly getting better.

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APPENDIX: G

Curriculum Vitae of Steven Gilyeart

JD with Honors (Law), BA with Honors (Economics)
Admitted before the US Tax Court

Leasing and Finance

Steven Gilyeart is an international attorney, government advisor, consultant, educator and businessman from Seattle, Washington, USA. He has an honors degree in law from the University of Texas, as well as an honors degree in economics from Oklahoma State University. He has been active in the leasing and finance fields in a number of capacities for more than 25 years.

As an attorney, he has represented leasing companies, banks, and other financial institutions in a variety of financial and other transactions and court proceedings. He is admitted to all courts, state and federal, in Washington, and to the United States Tax Court. He has a background in the world's major legal traditions, including common law, civil law, modern socialist systems and some Islamic law.

As a government advisor, he has provided assistance to four of the five most populous countries in the world (along with a number of smaller ones) in the development of policy and legislation to create or enhance the equipment finance and leasing industry in the country. Usually working with the Central Bank, Ministry of Finance, Ministry of Justice, Ministry of Trade, Parliament, the President's Office, Foreign Investment Office and high government agencies at the behest of the World Bank, Asian Development Bank, US Agency for International Development and other development institutions, he has provided policy advice and legislative draftsmanship covering commercial law, tax (direct and indirect), accounting, banking supervision, foreign investment, customs, foreign exchange, market development and other areas that might impact the country's equipment finance infrastructure.

Mr. Gilyeart is currently working on a leasing project in ***Georgia***. He has recently concluded leasing industry development projects for ***Albania***, ***Macedonia*** (3rd project), ***Ukraine*** and ***Nigeria***. In the past three years, he has also completed similar projects in ***Bosnia-Herzegovina, Serbia***, ***Mongolia***, ***Tajikistan***, ***Turkmenistan***, the ***Kyrgyz Republic***, ***Cambodia***, ***Estonia***, ***Lithuania, Latvia,*** and ***Macedonia*** (2nd project***)*** and an update seminar for the ***People's Republic of China.*** Previously, he has been involved with legislative and economic reform projects regarding the development of the leasing and capital asset finance industry in ***Romania***, ***Croatia***, ***Uzbekistan***, ***Nicaragua*** and ***Macedonia***. He has been the architect and draftsman of a complete legal framework (law, tax, accounting, licensing, regulatory and other policies, legislation, and regulations) that would allow for the emergence of an equipment finance and leasing industry in ***Lao People's Democratic Republic*** **(Laos)**. (There had previously been no financial leasing industry in Lao.) He has advised the ***Republic of Poland*** on legal and tax reforms to enhance and increase the country's financial leasing activity, and assisted the ***Russian Federation*** with its economic and legislative reforms, including advice respecting its proposed federal leasing law, tax and accounting policies, leasing company regulatory

schemes, and other related matters. He similarly advised the ***People's Republic of China*** respecting new leasing legislation and policies, the design of a credit bureau and development of a lease registry. In addition, he was an advisor to and a draftsman of a finance leasing law and regulatory structure for the leasing industry in the ***Socialist Democratic Republic of Sri Lanka,*** where he also reviewed the tax and accounting system for advisable change and developed a lease registration system and a national credit bureau. Previously, he was the draftsman of a leasing law and the designer of a personal property asset registration system for the ***Republic of Indonesia.***

In the ***United States*** he has served as an advisor to the National Conference of Commissioners on Uniform State Laws and was an active participant in the drafting of *Article 2A—Leases*, the article of the Uniform Commercial Code that covers leasing. He has also been involved with a number of pieces of leasing legislation in a number of US states.

As an educator, he has conducted seminars and training programs on a variety of leasing, finance, accounting, tax and law topics throughout the world. He is the author of ***The International Leasing Dictionary***, published electronically at *The International Leasing Resource*. He is also the author of Chapter 3, The International Legal Infrastructure, Chapter 7, Indirect Tax, and co-author of Chapter 4, The International Regulatory Structure of ***International Leasing--The Complete Guide*** (Amembal & Associates, 2000), Chapter 19, Legal Issues, in ***Operating Leases--The Complete Guide*** (Amembal & Associates, 2000), Article 2A—Statutory Analysis, ***Equipment Leasing*** (ed. Wong, Matthew Bender 1995, 99), Chapter 18: Lease Documentation and Chapter 19: Legal Issues in ***The Handbook of Equipment Leasing*** (Amembal & Halladay, 1995) and dozens of articles for various publications in the leasing field.

Since 1981 he has made over a hundred presentations and conducted workshops and seminars for lessors, lessees, attorneys, accountants, and others involved in leasing, both in the United States and abroad, including a training seminar for the first indigenous people's leasing company in ***Zimbabwe*** and an invited presentation at the ***ABD/OCED Workshop on SME Financing in Asia*** in Manila, the Philippines, in July, 2000, and continues to teach in-house programs for major lease companies, financial institutions and manufacturing companies with finance departments or financial subsidiaries.

Mr. Gilyeart has served as a registered lobbyist on behalf of the leasing industry and has participated in the enactment (and amendment) of numerous pieces of leasing legislation, both in the United States and abroad. He also serves as an arbitrator of commercial disputes.

He is a past member of the Board of Directors of the United Equipment Leasing Association (formerly WAEL), a past chairman of WAEL's Legal Committee and Government Affairs Committee, and has served on a number of WAEL task forces, including its long-range strategic planning task force. He has served as the Chairman of the Lawyer's Committee of the National Vehicle Leasing Association and has been actively involved with the Equipment Leasing Association (formerly "AAEL"), the Washington Association of Equipment Lessors, the Puget Sound Lessors' Group and the international lease community.

Technology

Mr. Gilyeart was published in the computer technology field at the dawn of the PC era and retains active interests in that area as well. He is a long-standing member of the Association for Computing Machinery, and an active member of the WSA, IEEE Computer Society and American Mathematical Association. He was a charter member of the Virtual World Society, and a prior member of the Interactive Communication Society and Northwest Cyber Artists. In 2001, he presented an invited position paper on Online Privacy and Trust at the ACM-SIG CHI Conference in Seattle. In November of 1981***, Interface Age*** published his prognostic article "The Paper Chase Meets the Chip", which has proven correct regarding windows, e-mail and electronic document filing. He has been approved as a peer reviewer for ***Computing Reviews***. He was an early member of The Well, an early web developer, and is still an occasional programmer.

Community Service

Mr. Gilyeart is currently a member of the US President's Business Commission, the Greater Seattle Chamber of Commerce and the Northwest Entrepreneur's Network. He has been a Member of the Seattle Mayor's Small Business Task Force, the past president of the Denny Regrade Business Association (a local "chamber of commerce"), and has served on the boards of various community non-profit organizations. He has also served as a member or chairman of a variety of bar association committees and as Special District Counsel/investigator for the bar regarding allegations of unethical attorney conduct. Early in his legal career, he argued the Washington Supreme Court case that established the definition of death in Washington State.